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No. 301

United States Court of Appeals for the First Circuit.

No. 5186.

DRAGON CEMENT COMPANY, INC.,
PLAINTIFF, APPELLANT,

v.

UNITED STATES OF AMERICA,
DEFENDANT, APPELLEE.

RECORD APPENDIX TO BRIEF FOR PLAINTIFF, APPELLANT.

ADDISON C. GETCHELL & SON, INC., LAW PRINTERS, BOSTON.

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RECORD APPENDIX.

United States District Court
District of Maine
Southern Division

DRAGON CEMENT COMPANY, INC., v. UNITED STATES OF AMERICA	Civil No. 4-90.

Relevant Docket Entries.

1955		
Aug	29	Complaint filed.
Aug	29	Summons issued.
Aug	30	Summons returned executed. Executed Aug 29 upon U. S. Attorney and on Aug 30 upon Director of I. R., and upon Atty. General, Washington, D. C. by registered mail,
Oct.	28	Answer of Def w/Affidavit of Service, filed.
Nov	8	Letter from Herbert E. Locke requesting entry of appearance of Joseph B. Campbell and James L. Reid.
1956		
May	16	Stipulation of Facts, filed.
May	22	Motion for Summary Judgment w/notice of motion and affidavits, filed.
May	22	Notice of pre-trial conference, to be held in Chambers, Portland, July 26, at 1 o'clock, mailed to Herbert E. Locke, Joseph B. Campbell, and James L. Reid—also to Peter Mills, U. S. Atty., along with extra copies to be mailed to Govt. counsel.

Jul 31 Defendant's Motion in Opposition to Plaintiff's Motion for Summary Judgment w/Affidavits and Cert. of service, filed.

Aug 15 Stipulation re oral argument on Plaintiff's Motion for Summary Judgment, filed.

Aug 17 Defendant's Cross-Motion for Summary Judgment w/Cert. of service, filed.

Aug 25 Plaintiff's Motion in Opposition to Defendant's Cross-Motion for Summary Judgment. Serviced by Peter Mills, U. S. Attorney. (Filed in Open Court U. S. D. C., Mass. District. Aug. 23, 1956).

Aug. 25 Opinion, Aldrich, J., that the defendant is entitled to a partial summary judgment of dismissal as to the depletion claim, and the plaintiff to a partial summary judgment in its favor as to the capital stock bonus loss. Formal order to be submitted.

Sep 24 Judgment, Aldrich, J., on motion of plaintiff for Summary Judgment for the relief demanded in the complaint and cross-motion of defendant for dismissal of the complaint and it appearing to the Court that there is no genuine issue as to any material fact and that plaintiff is entitled to judgment as a matter of law, it is hereby Ordered, Adjudged and Decreed that: 1. Plaintiff recover of defendant the sum of $9,690.42, together with interest thereon, as provided by law; and 2. That plaintiff take nothing further in consequence of plaintiff's complaint, as to the issue of percentage depletion and as to that issue, the action be and it hereby is dismissed on the merits, filed. Order, Aldrich, J., on motion of plaintiff and cross-motion of defendant for Summary Judg-

ment (1) that defendant is entitled to judgment, as a matter of law on the first issue, relating to the computation of the plaintiff's deduction for percentage depletion; and (2) that plaintiff is entitled to judgment as a matter of law for the second issue, relating to the deduction of a loss by reason of the payment of the Pennsylvania stock bonus, it is Ordered as to the second issue, that Summary Judgment be entered in favor of plaintiff in the amount of $9,690.42, together with interest thereon, as provided by law, and that the plaintiff have execution therefor. As to the first issue, that Summary Judgment be entered in favor of defendant, that plaintiff take nothing, filed.

Oct 9 Amended page 5 of Opinion, Aldrich, J., filed.

Oct 19 Letter dated October 18, 1956 from Judge Aldrich to Morris Cox, Clerk requesting the Clerk to make an entry that the government's recent motion to amend the order and judgment in the above case is allowed, and notify counsel.

Oct 19 Motion to Amend Order and Judgment w/Order, Aldrich, District Judge: Ordered, Adjudged and Decreed by the Court that the Order and Judgment thereon entered in the above entitled cause on the 24th day of September, 1956, be, and hereby are amended by striking out the figures "$9,690.42" wherever appearing therein, and inserting in both in lieu thereof the figures "$10,546.46", filed.

Oct 22 Frederic A. Collins, Herbert E. Locke, Gerard J. O'Brien and Peter Mills, notified of allowance of government's motion to amend the order and judgment.

Oct 22 Notice of Appeal filed by Herbert E. Locke.
Oct 22 Duplicate of Notice of Appeal mailed to Peter Mills, U. S. Attorney.
Oct 23 Notice of Appeal filed by Peter Mills.
Oct 23 Duplicate copy of Notice of Appeal filed Oct 23, 1956 mailed to Herbert E. Locke.

Complaint.

[Filed August 29, 1955.]

1.

Plaintiff brings this action against Defendant pursuant to Section 1346(a)(1) of Title 28 of the United States Code, Act of June 25, 1948, c. 646, 62 Stat. 869, 933, as amended by the Act of July 30, 1954, c. 648, #1, 68 Stat. 589.

2.

This action is brought for the recovery of $305,440.01 of income tax and of $178,082.18 of excess profits tax collected from Plaintiff as successor to Lawrence Portland Cement Company for the fiscal period January 1, 1951 to November 30, 1951, hereinafter referred to as the "tax period".

3.

Plaintiff is a corporation incorporated and doing business under the laws of the State of Maine, located at Thomaston, in the County of Knox, within this District and Division.

4.

Throughout the said "tax period" Lawrence Portland Cement Company was a corporation incorporated and doing business under the laws of the Commonwealth of Pennsylvania and was qualified to do and did do business in the State of Maine within this District and Division.

5.

Plaintiff and Lawrence Portland Cement Company duly entered into an Agreement of Merger, dated September 28, 1951, duly approved by their respective Boards of Directors, pursuant to which Lawrence Portland Cement Company was merged into Plaintiff.

6.

The Agreement of Merger provided:

(a) That Plaintiff should continue as the surviving corporation.

(b) That the capital stock of Lawrence Portland Cement Company should be converted into capital stock of Plaintiff on a share for share basis.

(c) That all issued and outstanding shares of Lawrence Portland Cement Company should be cancelled as of the effective date of the merger.

(d) That Plaintiff should acquire all the rights, privileges, powers, franchises, immunities and every other interest of Lawrence Portland Cement Company and Plaintiff should assume all debts, liabilities and duties of Lawrence Portland Cement Company.

7.

Said Agreement of Merger and the plan of merger therein contained was adopted by the stockholders of Lawrence Portland Cement Company on October 18, 1951.

8.

Said Agreement of Merger and the plan of merger therein contained was adopted by the stockholders of Plaintiff on November 23, 1951.

9.

The act of merger was duly executed in accordance with the laws of the State of Maine and the Commonwealth of Pennsylvania and became effective at the close of business on November 30, 1951.

10.

Upon consummation of the act of merger, Plaintiff acquired all the rights, privileges, powers, franchises, immunities and every other interest of Lawrence Portland Cement Company and Plaintiff assumed all debts, liabilities and duties of Lawrence Portland Cement Company.

11.

Lawrence Portland Cement Company kept its books and reported its income on a calendar year basis.

12.

On March 12, 1952, the then Commissioner of Internal Revenue granted Plaintiff, on behalf of Lawrence Portland Cement Company, an extension of time, for such period as might be necessary but not later than September 15, 1952, within which to file its Corporation Income Tax Return for the said "tax period".

13.

Lawrence Portland Cement Company made and filed an income and excess profits tax return for the said "tax period" as a taxpayer not in existence during the whole annual accounting period of 1951 and computed its income tax and excess profits tax for the said "tax period" pursuant to Sections 47(g) and 433(a)(2)(B), respectively, of the Internal Revenue Code of 1939.

14.

Such tax return for the said "tax period" showed income tax liability of $1,015,083.18, excess profits tax liability of $186,797.27, and a total tax liability of $1,201,880.45.

15.

The income and excess profits tax liability of $1,201,880.45 shown on such return was duly paid by Plaintiff, as

successor to Lawrence Portland Cement Company, on or about the following dates:

On or about February 15, 1952	$ 450,000.00
On or about May 14, 1952	$ 360,000.00
On or about August 14, 1952	$ 270,000.00
On or about November 14, 1952	$ 121,880.45

16.

On December 15, 1954 the District Director of Internal Revenue mailed a notice of deficiency which enclosed a Revenue Agent's report dated October 29, 1954.

17.

The Revenue Agent's report referred to in paragraph 16 above proposed a deficiency of $65,367.71 of income and excess profits tax for the said "tax period" for various reasons set forth therein.

18.

Pursuant to such Revenue Agent's report the then Commissioner made an additional assessment of $65,367.71 of income and excess profits tax and of $10,695.22 interest thereon. Plaintiff, as successor to Lawrence Portland Cement Company, duly paid such assessment on or about February 17, 1955 to Denis J. McMahon, then District Director of Internal Revenue for the Lower Manhattan District.

19.

On February 14, 1955, Plaintiff, as successor to Lawrence Portland Cement Company, duly filed with the District Director of Internal Revenue for the Lower Manhattan District a claim for refund for the overpayment of income and excess profits tax for the said "tax period" in the amount of $494,305.02 or such greater amount as is legally refundable, together with statutory interest thereon. A recomputation of the amount of refund due on the

facts therein alleged show such refund to amount to $483,522.19. Such claim for refund separately alleged that the then Commissioner had erred in allowing percentage depletion in the amount of $204,859. under Section 114(b)(4) of the Internal Revenue Code of 1939 in that the amount properly allowable was $795,852.60, and separately alleged that the then Commissioner had erred in not allowing the deduction as a loss pursuant to Section 23(f) of the Internal Revenue Code of a capital stock bonus payment to the Commonwealth of Pennsylvania in the amount of $12,015., and set forth the grounds upon which this suit is brought.

20.

On or before May 12, 1955 the District Director, pursuant to Section 6532(a)(1) of the Internal Revenue Code of 1954, and Section 3772(a)(2) of the Internal Revenue Code of 1939, mailed by registered mail a notice of disallowance, dated May 11, 1955, of such claim for refund referred to in paragraph 19 above.

21.

Plaintiff is entitled to the deductions as alleged in paragraph 19 above, therefore Plaintiff has overpaid its income and excess profits tax in the amounts of $305,440.01 and $178,082.18, respectively.

22.

Throughout the said "tax period" Lawrence Portland Cement Company owned and operated two cement rock quarries, one located in Knox County, Maine, and the other in Northampton County, Pennsylvania. It was engaged in the business of mining cement rock from the quarries and processing the same by the application of ordinary treatment processes into cement.

23.

Such cement rock is a calcium carbonate within the meaning of Section 114(b)(4) of the Internal Revenue Code of

1939, as specified by Treasury Regulations 111, Section 29.23(m)-5, as amended by T.D. 6031, C.B. 1953-2, 120, July 14, 1953, which provides:

> "Calcium carbonates—Miscellaneous limestones and other calcium carbonate rocks (not specifically provided for at a 5 percent or 15 percent rate of percentage allowance) such as cement rock and limestone used or sold for use in soil treatment. * * * *"

24.

Section 23(m) of the Internal Revenue Code of 1939 provides for a deduction in computing net income of an allowance for depletion of "mines, oil and gas wells, other natural deposits and timber". Section 114(b)(4)(A) of the Internal Revenue Code of 1939 provides that effective on and after January 1, 1951 the allowance for depletion under Section 23(m) in the case of "calcium carbonates" shall be 10% of the "gross income from the property" during the taxable year, but not to exceed 50% of the taxpayer's net income from the property, computed without allowance for depletion.

25.

The term "gross income from the property" as used in Section 114(b)(4)(A) of the Internal Revenue Code of 1939 is defined in Section 114(b)(4)(B) which states that:

> ". . . . 'gross income from the property' means the gross income from mining. . . ."

and that

> "'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. . . ."

26.

Lawrence Portland Cement Company sold and Plaintiff presently sells all of the cement rock mined in the form of cement except for negligible amounts sold as an accommodation to employees and neighbors for driveways and walks for which chemical composition is not a major requirement.

27.

There was no market for the cement rock mined by Lawrence Portland Cement Company before it was processed into cement and there is presently no market for the cement rock mined by Plaintiff until such cement rock is processed into cement.

28.

The following are the processes applied by Lawrence Portland Cement Company during the said "tax period" and presently applied by Plaintiff to the cement rock mined from its quarry at Thomaston, Maine in order to process the said rock into cement:

(a) The cement rock is mined by the open pit method by drilling and primary blasting from the face of the quarry.

(b) The rock is further broken into manageable size by secondary or squib blasting.

(c) The cement rock is loaded by shovels into dump trucks which carry it to an inclined railway where it is deposited into dump rail cars.

(d) The dump rail cars deposit the cement rock into a large primary crusher which reduces the size of the rock to pieces with a maximum dimension of about eight inches.

(e) The cement rock, after the primary crushing, falls onto a conveyor belt which takes it to the secondary crusher which further reduces the size of the stone.

(f) From the secondary crusher, a conveyor belt carries the cement rock to a shed.

(g) The cement rock in the shed is picked up by an overhead crane which deposits the desired quantities into a hopper, over which a coarse bar grate is fitted.

(h) The cement rock is gravity-fed from the hopper to a ball mill where it is ground with water to the proper fineness for burning in the kilns. The quantity of water is adjusted to produce a slurry which can be pumped readily. In the production of certain types of cement, which constitute only about one-ninth of the total production, minute quantities of sand and iron ore are added prior to the introduction of the cement rock into the ball mills.

(i) The resulting slurry is conveyed to a wet slurry tank where the wet mix is kept in suspension by a revolving paddle mechanism.

(j) Cement rock slurry is run off to filters where much of the water is removed. The filter cake is conveyed by belt to the kilns (the filter stage is omitted for about one-half of the cement rock processed).

(k) The slurry is run into the upper end of rotary kilns which are in the form of long cylinders set at a slight inclination and it travels gradually toward the lower end. Hot gases from an oil flame at the lower end burn the cement rock to a dense clinker.

(l) The burned cement rock is conveyed to a grinding mill where it is ground to the fineness of cement. At this stage a small quantity of gypsum is added to control the time of setting.

(m) The cement is placed in silos from which it is loaded and shipped in bags or in bulk.

29.

The processes applied by Lawrence Portland Cement Company during the said "tax period" and by Plaintiff

to the cement rock mined at Northampton, Pennsylvania, in order to put it in the form of cement are almost identical with those applied to the cement rock mined at Thomaston, Maine, as alleged in paragraph 28 above, except that in addition to the negligible quantities of sand and iron ore sometimes added as alleged in sub-paragraph (h) of said paragraph 28, varying relatively small percentages of metallurgical grade limestone are added and no water is added prior to placing the cement rock in the ball mills.

30.

(a) The processes listed in paragraphs 28 and 29 above are the ordinary treatment processes by which cement rock is processed into cement.

(b) In the case of cement rock, cement is "the commercially marketable mineral product or products" as that term is used in Section 114(b)(4)(B) of the Internal Revenue Code of 1939 and the processes described in paragraphs 28 and 29 above are, within the meaning of that Section, "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products".

31.

Lawrence Portland Cement Company for the said "tax period" used the percentage depletion method prescribed in the Internal Revenue Code of 1939, Section 114(b)(4)(A) in computing the depletion deduction for its cement rock under Section 23(m) of the Internal Revenue Code of 1939. Lawrence Portland Cement Company computed the amount of its deduction for percentage depletion pursuant to the terms of a letter dated May 16, 1952 addressed to the American Mining Congress by Dan J. Ferris, then Head of Branch for E. I. McLarney, then Deputy Commissioner of Internal Revenue. The portion of said letter under which Lawrence Portland Cement Company com-

puted its percentage depletion was subsequently formalized as Revenue Ruling 290, C.B. 1953-2, 41.

32.

Said letter dated May 16, 1952 and said Revenue Ruling 290 are invalid and erroneous because they are in conflict with Section 114(b)(4)(B) of the Internal Revenue Code of 1939 in that said letter and Revenue Ruling provide for the exclusion of the income attributable to the processes listed in sub-paragraphs (k), (l) and (m) of paragraph 28 above.

33.

The deduction for percentage depletion was computed pursuant to said letter later formalized by invalid Revenue Ruling 290 as $205,457.95 which, due to minor adjustments, was computed by the examining Revenue Agent to be $204,859.19 when in fact it should have been computed as $795,852.60.

34.

All the income attributable to extracting the cement rock from the ground and to the treatment processes applied to process it and load it for shipment is properly income from "mining" and thus "gross income from the property", as those terms are defined in Section 114(b)(4)(B) of the Internal Revenue Code of 1939.

. . . . . .

41.

The said action of the Commissioner in excluding certain processes as ordinary treatment processes thus excluding the income attributable to them from "gross income from the property" and in denying the deduction for the Pennsylvania bonus tax and subsequently disallowing Plaintiff's claim for refund based on said deductions for the said "tax period" was erroneous, illegal and without warrant in law.

. . . . . .

43.

By reason of the facts set forth in this complaint, there is now due and owing from Defendant to Plaintiff the sum of $483,522.19 with interest thereon as provided by law from the dates of payment thereof; that is, on $76,062.93 from February 17, 1955, on $121,880.45 from November 14, 1952, on $270,000. from August 14, 1952, and on $15,578.81 from May 14, 1952. Such sum of $483,522.19 was erroneously and illegally collected from Plaintiff as income and excess profits taxes and interest for the said "tax period". Although repayment thereof has been demanded, no part of the sum of $483,522.19 has been credited, remitted, refunded or repaid to the Plaintiff or to anyone on its account.

Wherefore, Plaintiff demands judgment against Defendant in the principal amount of $483,522.19 and interest thereon as provided by law from the dates of payment hereinabove specified, together with costs.

Respectfully submitted,

HERBERT E. LOCKE
Herbert E. Locke
Depositors Trust Building
Augusta, Maine
Counsel for Plaintiff

Dated August 26, 1955.

Of Counsel:
Locke, Campbell, Reid & Hebert
Depositors Trust Building
Augusta, Maine
Clark, Carr & Ellis
120 Broadway
New York 5, New York

Answer.

[Filed October 28, 1955.]

Comes the defendant and for its answer to plaintiff's complaint says:

1. Admits the allegations contained in paragraph 1.
2. Admits the allegations contained in paragraph 2.
3. Admits the allegations contained in paragraph 3.
4. Admits the allegations contained in paragraph 4.
5. Admits the allegations contained in paragraph 5.
6. Admits the allegations contained in paragraph 6.
7. Admits the allegations contained in paragraph 7.
8. Admits the allegations contained in paragraph 8.
9. Admits the allegations contained in paragraph 9.
10. Admits the allegations contained in paragraph 10.
11. Admits the allegations contained in paragraph 11.
12. Admits the allegations contained in paragraph 12.
13. Admits the allegations contained in paragraph 13.
14. Admits the allegations contained in paragraph 14.
15. Admits the allegations contained in paragraph 15.
16. Admits the allegations contained in paragraph 16.
17. Admits the allegations contained in paragraph 17.
18. Admits the allegations contained in paragraph 18.
19. Denies the allegations contained in paragraph 19, except that it is admitted that on February 14, 1955, plaintiff filed claims for refund aggregating $494,305.02. Except as admitted in this answer, the allegations contained in the claims for refund and in support thereof are denied.
20. Admits the allegations contained in paragraph 20.
21. Denies the allegations contained in paragraph 21.
22. Denies the allegations contained in paragraph 22, except that it is admitted that plaintiff engaged in the business of mining cement rock and in manufacturing cement.
23. Admits the allegations contained in paragraph 23.
24. Admits the allegations contained in paragraph 24.

25. Admits the allegations contained in paragraph 25.

26. Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 26.

27. Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 27.

28. Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 28, except that it is denied that treatment processes produce cement from cement rock as mined.

29. Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 29.

30. Denies the allegations contained in paragraph 30.

31. With respect to paragraph 31, defendant admits that Lawrence Portland Cement Company used the percentage depletion method prescribed in the Internal Revenue Code of 1939, Section 114(b)(4)(A) in computing the depletion deduction for its cement rock under Section 23(m) of the Internal Revenue Code of 1939, but is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations in said paragraph 31.

32. Denies the allegations contained in paragraph 32.

33. Denies the allegations contained in paragraph 33.

34. Denies the allegations contained in paragraph 34.

. . . . . .

41. Denies the allegations contained in paragraph 41.

. . . . . .

43. Denies the allegations contained in paragraph 43, except that it is admitted that no part of the sum of $483,522.19 has been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account.

Wherefore, defendant prays that plaintiff's action be dismissed at its cost.

PETER MILLS
United States Attorney

Stipulation of Facts.

[Filed May 16, 1956.]

It is stipulated and agreed between the parties by their respective attorneys of record that for the purposes of this cause the following facts shall be taken as true, subject to objection by either party, and neither party to be precluded from adducing additional evidence or testimony at the trial:

FIRST ISSUE

1. Plaintiff is a corporation incorporated under the laws of the State of Maine and is located at Thomaston, Maine.

2. Plaintiff, by appropriate act of merger, acquired all the rights, privileges, powers, franchises, immunities and every other interest of Lawrence Portland Cement Company, a Pennsylvania corporation, and plaintiff assumed all debts, liabilities and duties of said corporation, all effective on November 30, 1951.

3. Lawrence Portland Cement Company kept its books on a calendar year basis and made and filed an income and excess profits tax return for the "tax period", January 1, 1951 through November 30, 1951, as a taxpayer not in existence during the whole annual accounting period of 1951.

4. The income and excess profits tax liability of $1,201,880.45 shown on such return was duly paid by plaintiff as successor to Lawrence Portland Cement Company.

5. Pursuant to a deficiency found by the District Director of Internal Revenue, an additional assessment of $65,367.71 and $10,695.22 interest was duly paid by plaintiff as successor to Lawrence Portland Cement Company.

6. On February 14, 1955, plaintiff, as successor to Lawrence Portland Cement Company, duly filed with the District Director of Internal Revenue for the Lower Manhattan District a claim for refund.

7. Said claim for refund was duly denied by notice of disallowance dated May 11, 1955.

8. Throughout the said "tax period" Lawrence Portland Cement Company owned and operated two quarries, one located in Knox County, Maine, and the other in Northampton County, Pennsylvania, from which it extracted a calcium carbonate rock, commonly known as cement rock, suitable for conversion into cement. Treasury Regulation 111, Section 29.23(m)-5, as amended by T.D. 6031, Cum. Bull. 1953-2, 120, July 14, 1953, provides that "calcium carbonates" within the meaning of Section 114(b)(4) of the Internal Revenue Code of 1939 include calcium carbonate rocks, such as "cement rock".

9. The parties agree that the operations set forth in subparagraphs (a) and (b) hereof, are or may be included in determining gross income from mining of the mineral product, cement rock, which operations were employed by Lawrence Portland Cement Company during the said "tax period" and are employed by plaintiff presently at its quarry at Thomaston, Maine:

(a) Extraction incurred in the following operations:

(1) Drilling and primary blasting from the face of the quarry by the open pit method to obtain the mineral product, cement rock.

(2) Secondary or squib blasting to further break the cement rock into manageable size.

(3) Loading by shovels into dumptrucks which carry the cement rock to an inclined railway where it is deposited into dump rail cars for transportation to the plant.

(b) Treatment or beneficiation incurred in the following operations:

(1) The dump rail cars deposit the mineral product, cement rock, into a large primary crusher, which reduces the size of the extracted rock to pieces with a maximum dimension of about eight inches.

(2) After primary crushing, the crushed cement rock falls onto a conveyor belt which takes it to a secondary crusher which further reduces the size of the rock.

(3) From the secondary crusher, a conveyer belt carries it to a shed.

(4) From the shed it is picked up by an overhead crane which deposits the desired quantities into a hopper, over which a coarse bar grate is fitted to screen the crushed cement rock.

(5) From the hopper the screened cement rock is gravity-fed to a ball mill where it is ground with water to a proper fineness known as "slurry".

(6) The slurry is conveyed to a wet slurry tank where it is kept in suspension by a revolving paddle mechanism.

(7) The slurry is run off to filters where much of the water is removed. A resulting filter cake is conveyed by belt to rotary kilns.

10. The parties are in disagreement as to further operations being included in the computation of plaintiff's gross income from the mining of the mineral product, cement rock. Defendant contends the "ordinary treatment processes" normally applied by mine owners or operators to the mineral product, cement rock, have ceased. Plaintiff contends that the following are "ordinary treatment processes" normally applied by mine owners or operators and are properly included in the computation of plaintiff's gross income from mining:

(1) The filter cake is run into the upper end of rotary kilns, which are in the form of long rotating

cylinders set at a slight inclination, and it travels gradually toward the lower end. Hot gases from a flame at the lower end evaporate the water from the filter cake and burn the remaining material to a dense clinker.

(2) The clinker is conveyed to a grinding mill where it is ground to the fineness of cement.

(3) The cement is placed in silos from which it is loaded and shipped in bags or in bulk.

11. The parties agree that the operations described above are identical with those which Lawrence Portland Cement Company employed in the "tax period" and plaintiff presently employs at its quarry at Northampton, Pennsylvania, except that no water is added prior to placing the mineral product, cement rock, in the ball mills.

. . . . . .

CONCLUSION

No part of the sum claimed by plaintiff has been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account. Based on the decision of this Court, the taxes in question shall be recomputed.

Executed this 16th day of May, 1956.

HERBERT E. LOCKE
Herbert E. Locke

JAMES L. REID
James L. Reid

JOSEPH B. CAMPBELL
Joseph B. Campbell,
Attorneys for Plaintiff.

CLARK, CARR & ELLIS
Clark, Carr & Ellis
Of counsel for Plaintiff

PETER MILLS
Peter Mills
United States Attorney

Motion for Summary Judgment.

[Filed May 22, 1956.]

The plaintiff, by its attorneys, hereby moves the Court to enter summary judgment for the plaintiff, in accordance with the provisions of Rule 56 (a) and (c) of the Rules of Civil Procedure, on the ground that the pleadings, the Stipulation of Facts dated May 16, 1956 and filed on May 16, 1956, and the affidavits of James H. Ackerman, Dr. Robert H. Bogue, William H. Klein and John M. Pomeroy, attached hereto, show that the plaintiff is entitled to judgment as a matter of law.

HERBERT E. LOCKE
Herbert E. Locke
Depositors Trust Building
Augusta, Maine

Of Counsel:

Locke, Campbell, Reid & Hebert
Depositors Trust Building
Augusta, Maine

Clark, Carr & Ellis
120 Broadway
New York 5, New York

To: Hon. Peter Mills
United States Attorney
Attorney for Defendant:

Please take notice that the undersigned will bring the attached Motion for Summary Judgment on for hearing before the Honorable John D. Clifford, Jr., in the Court Room of the United States District Court for the District of Maine, Southern Division, on the 8th day of June, 1956 at ten o'clock A. M., or as soon thereafter as counsel can be

heard, and that the motion will be submitted upon the pleadings, the Stipulation of Facts dated May 16, 1956 and filed on May 16, 1956, and the affidavits attached hereto.

May 21, 1956.

HERBERT E. LOCKE
Herbert E. Locke
Depositors Trust Building
Augusta, Maine

Of Counsel:

Locke, Campbell, Reid & Hebert
Depositors Trust Building
Augusta, Maine

Clark, Carr & Ellis
120 Broadway
New York 5, New York

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

James H. Ackerman, of Princeton, County of Mercer, State of New Jersey, deposes as follows:

1. I am and have been since organization, the President of Dragon Cement Company, Inc., the plaintiff herein. I was associated with plaintiff's predecessor, Lawrence Portland Cement Company since 1929 as Assistant to the President, Sales Manager and Vice-President in Charge of Sales, and as President since 1943. I have been a Director of the Portland Cement Association during various periods and I am presently a Director.

2. During the thirty-five years of my association with plaintiff and its predecessor I have been actively concerned with sales problems of plaintiff and the industry and can positively state that there is no market for the mineral, cement rock, except in the form of finished cement. At

Thomaston, Maine, because of the fact that the nearest quarry of material suitable for driveways and the like is approximately thirty miles distant, the plaintiff has, as an accommodation to residents of the Village of Thomaston, sold cement rock, at cost and not commercially, for use in incidental driveway and sidewalk work. I have carefully compared the books of the plaintiff and find that these sales were negligible during the period January 1, 1951 to November 30, 1951 and amounted to less than 17/100ths of 1% of the total sales of plaintiff and approximately the same percentage has prevailed both before and since that period. The plaintiff has made attempts to market cement rock but said cement rock has always been rejected in any commercial market in any form except cement.

3. I am thoroughly familiar with the ordinary treatment processes applied by mine owners or operators in the cement business. All cement rock miners employ the steps listed in paragraphs 9 and 10, sub-paragraphs (1) through (3), or paragraph 11, of the Stipulation of Facts in order to produce Portland cement.

4. On September 13, 1955, plaintiff herein filed its final income tax return for the calendar year 1954 in which its allowance for percentage depletion was computed on the basis of including the steps listed in paragraph 10, sub-paragraphs (1) through (3), and paragraph 11, of the Stipulation of Facts. On November 1, 1955, the District Director of Internal Revenue for the Lower Manhattan District of New York refunded the sum of $559,209., plus interest in the amount of $11,735.73, which represented the difference between the tax computed as plaintiff contends is proper and the tax computed as defendant contends is proper.

5. This affidavit is made in support of plaintiff's Motion for Summary Judgment.

JAMES H. ACKERMAN

Sworn to before me this 18th day of May, 1956.

ERIC JANSON
Notary Public

(SEAL)

(County Clerk's Certificate attached.)

DISTRICT OF COLUMBIA : SS.:

Dr. Robert H. Bogue, of the City of Washington, District of Columbia, deposes as follows:

1. I received the degrees of Bachelor of Science in Chemistry at Tufts College, 1912, Phi Beta Kappa; Master of Science in Chemistry at the University of Massachusetts, 1915, and Doctor of Philosophy in Physical Chemistry at the University of Pittsburgh, 1920. I was instructor in chemistry at the University of Massachusetts 1912-1915; Assistant Professor in chemistry at Montana State College 1915-1917; Fellow at the Mellon Institute for Industrial Research, 1917-1922; Associate Professor of chemistry, Lafayette College, 1922-1924 and I directed research on portland cement at the National Bureau of Standards from the latter date until October 1, 1954. Since that time I have acted as a consultant on cement.

I am the author of "The Chemistry of Portland Cement" "Colloidal Behavior", "Chemistry and Technology of Gelatin and Glue" and about one hundred technical articles in the field of chemistry theory and technology. I am a member of the International Symposia on cement chemistry and co-organizer of International meetings on that subject in 1938 and 1952.

I have lectured on cement and/or consulted for the cement industry in England, Sweden, Denmark, Holland, Belgium, France, Germany, Switzerland, Italy and Spain. In 1950-1951, I accepted an invitation from the Spanish Government to lecture and hold conferences on cement chemistry and technology at the Technical Institute for

Materials of Construction, The Supreme Council for Research, the Royal Academy and the Engineering University of Barcelona.

2. I am familiar with and have visited a great many of the plants of producers of cement both in this country and abroad and am thoroughly familiar with the methods and processes employed. I have carefully examined the natural deposits and the plants of Dragon Cement Company, Inc. at Northampton, Pennsylvania and Thomaston, Maine. I have not found these deposits to consist of nor to contain any ores. I define a mineral as any naturally occurring inorganic substance having a definite chemical composition. I define an ore as any naturally occurring inorganic substance that contains metallic constituents in such proportion as to make their recovery profitable. These definitions are in accord with the concepts of authorities in the field of mineralogy and geology.

I find that the term "minerals" as used in the Internal Revenue Code of 1939 applies to the deposits of Dragon Cement Company, Inc. at Northampton and at Thomaston. The term "ores" in the Code, as in my definition, is limited to the "ores of the metals". Hence, the above deposits must be considered as minerals and not as ores, both by my definitions and by those employed in the statute and the regulations.

3. In this country, all portland cement is made in rotary kilns either by the dry process (in which the raw materials are ground in the dry state and introduced into the kiln in a dry condition), or by the wet process (in which the raw materials are ground in the presence of water and introduced into the kiln in the form of a wet slurry or filter cake). The operations are largely standardized for each process, although many details vary from plant to plant. The operations above outlined as employed by Dragon Cement Company, Inc. (the dry process at Northampton and the wet process at Thomaston) are substantially iden-

tical with the corresponding processes as employed by plaintiff and generally by other processors of portland cement throughout the United States. They are the "ordinary treatment processes" by which cement rock is processed into portland cement.

Due to the economic factors, including transportation costs, and the nature of the mineral product, I can categorically state there is no market whatsoever for cement rock prior to its being processed into cement. I would know of a commercial market for such a mineral product if such market, in fact, existed.

There are negligible quantities of cement rock sold at cost as a local accommodation for the sake of good will or as an accommodation from one miner of cement rock to another during a period when a flood in the quarry would otherwise have closed down the latter's operation with consequent local unemployment and distress. I have carefully examined the statistics compiled by the Bureau of Mines showing the tons of cement rock purchased. These statistics indicate that in the calendar year 1951 about 1/10 of one percent of the cement rock processed into cement was purchased and that negligible amount was purchased by a single plant.

4. This affidavit is made in support of plaintiff's motion for summary judgment.

ROBERT H. BOGUE

Subscribed and sworn to before me, a Notary Public in and for the District of Columbia, this 18th day of May, 1956.

BYRD C. REID
Notary Public

(SEAL)

My Commission expires 11/14/60

(County Clerk's Certificate attached)

STATE OF NEW YORK
COUNTY OF NEW YORK } ss.:

William H. Klein, of Easton, County of Northampton, Commonwealth of Pennsylvania, deposes as follows:

1. I am a Director and Vice-President in Charge of Production of the plaintiff herein. I am a Chemical Engineer, graduate of the University of Michigan, 1906, and have been engaged in the production of cement since 1906 as a Chemist and subsequently as Superintendent of United Kansas Portland Cement Co. until 1911, then was Superintendent of Dixie Portland Cement Co. until 1926; Operating Manager and subsequently Vice-President and Director of Pennsylvania-Dixie Cement Corporation from then until 1946 and, after a one year period as a Consultant, have been a Vice-President and Director of plaintiff and its predecessor since that time. I have been a member of the General Technical Committee of the Portland Cement Association and its predecessor since 1919 and was Chairman for twelve years. I have been a member of Committee C-1 on Cement of the American Society for Testing Materials since 1919 and have been a member of committees of the American Concrete Institute and the American Standards Association. I have had free access to all cement plants in this country and have visited most of them.

2. All cement rock miners employ the steps listed in paragraphs 9 and 10, sub-paragraphs (1) through (3), or paragraph 11, of the Stipulation of Facts in order to produce Portland cement.

3. Cement rock is not suitable for any use except the production of cement because it contains soft, friable and unsound constituents.

4. The cement rock mined by plaintiff contains no metallic constituents which can be profitably extracted therefrom and is a mineral and not an ore.

5. This affidavit is made in support of plaintiff's Motion for Summary Judgment.

WILLIAM H. KLEIN

Sworn to before me this 18th day of May, 1956.

ERIC JANSON
Notary Public

(SEAL)

(County Clerk's Certificate attached)

STATE OF MAINE }
COUNTY OF KNOX } ss.:

John M. Pomeroy, of Camden, County of Knox, State of Maine, deposes as follows:

1. I am a Vice-President and Director of the plaintiff. I am a graduate of the University of Maine (B.S. 1917) and after ten years with the St. Croix Paper Company, have been associated with plaintiff since 1928 and have been Manager of its Thomaston plant since 1946. I am a member of the Maine Association of Engineers and a member of the Portland Cement Association Committee on Industrial Safety.

2. All cement rock miners employ the steps listed in paragraphs 9 and 10, sub-paragraphs (1) through (3), or paragraph 11, of the Stipulation of Facts in order to produce Portland cement.

3. Cement rock is not suitable for any use except the production of cement because it contains soft, friable and unsound constituents.

4. The cement rock mined by plaintiff contains no metallic constituents which can be profitably extracted therefrom and is a mineral and not an ore.

5. This affidavit is made in support of plaintiff's Motion for Summary Judgment.

JOHN M. POMEROY

Sworn to before me this 18th day of May, 1956.

ALAN B. BIRD
Notary Public

Defendant's Motion in Opposition to Plaintiff's Motion for Summary Judgment.

[Filed July 31, 1956.]

Comes now the United States of America, the above named defendant, by its attorney Peter Mills, United States Attorney in and for the District of Maine, and moves the Court to deny plaintiff's motion for summary judgment on the ground that the pleadings filed herein and the affidavits attached hereto and made a part hereof, show that there is a genuine issue as to a material fact involved in this action and that therefore plaintiff is not entitled to a judgment as a matter of law.

PETER MILLS
United States Attorney

DISTRICT OF COLUMBIA : SS.:

Dr. Oliver Bowles, of the City of Washington, District of Columbia, deposes as follows:

1. I received the degree of Bachelor of Arts and Master of Arts at the University of Toronto, Canada, and degree of Doctor of Philosophy at George Washington University, Washington, D. C.

I was instructor in petrography at the University of Michigan for one year and instructor in mineralogy at the University of Minnesota for five years. Since 1914 I have been employed practically continually at the United States Bureau of Mines, chiefly in economic problems of non-metallic minerals, including the stone, lime and cement industries.

2. I am author of Bureau of Mining Bulletin 160 entitled "Rock Quarrying For Cement Manufacture", in the preparation of which I visited sixty-four Portland Cement plants in the United States. During this study I gave special attention to the raw materials used in cement manufacture and the various combinations of limestone, clays and other materials so employed. I am also the author of a 500 page volume entitled "The Stone Industries" published by the McGraw Hill Book Company. I am also the author of about three or four hundred other publications about non-metallic minerals.

3. I am a member of the American Institute of Mining, Metallurgical and Petroleum Engineers, the Society of Economic Geologists, Minerological Society of America, and an Honorary Member of the Institute of Quarrying of Great Britain.

4. Since my retirement from Government service a few years ago I have been employed as a consultant in mining and geology.

5. The earth's surface contains inorganic substances having a definite chemical composition properly referred to as "minerals". Calcium carbonate is one such mineral. "Cement rock" is a mixture of calcium carbonate and clay.

6. Cement rock as it naturally exists may be a satisfactory raw material for making Portland Cement, but sometimes additions of limestone, clay, silica or iron oxide may be necessary to make a proper mixture.

7. The manufacture of Portland Cement involves two principal processes. First, those listed in paragraph 9(a) and (b) of the Stipulation of Facts of this proceeding are for the preparation and proportioning of the raw materials and secondly, those listed in paragraph 10 of the Stipulation of Facts are the manufacturing processes which consist of calcining the raw materials in kilns. This latter process involves chemical reactions and the formation of

synthetic products such as calcium and aluminate silicates which are not found in nature.

8. First, the preparation of the raw materials involved proportioning of various minerals such as cement rock or limestone and clay, or sometimes in process of purification, for instance, some cement plants use the flotation process for removing impurities and thus preparing a suitable raw material. Such flotation process together with the proportioning of the various raw materials that may be used would be defined as the "ordinary treatment processes" employed in preparing the raw materials ready for the manufacturing process. Secondly, the calcination or heat treatment of the raw materials in the cement for the production of the finished product, Portland Cement, is a manufacturing process and is not to be defined as an ordinary treatment process of minerals. The reactions that take place in the Portland Cement rotary kiln are very complex. Reactions take place between limestone, cement rock, clay or other ingredients to form tricalcium silicate, dicalcium silicate, tricalcium aluminate and tetracalcium aluminoferrite. These are synthetic compounds none of which occur in nature and the mixture comes from the kiln in the form of a clinker which is later pulverized into the finished cement. Such complex factory processes are not to be confused with the ordinary flotation or other methods employed to prepare the raw materials for use.

9. The term "ordinary treatment processes" is presumed to apply to the purification or preparation in other ways of minerals in order that they may be prepared in suitable form for later manufacturing processes, but even after such preliminary treatment they are still minerals. A mineral may be defined as any naturally occurring inorganic substance having a definite chemical composition. Portland Cement clinker is not a mineral because it does not occur in nature. It is a combination of complex syn-

thetic substances. In other words, the manufacture of Portland Cement in a rotary kiln is comparable with the manufacture of pig iron from iron ore in a shaft kiln which I note from the statute Congress has not permitted to be included as an ordinary treatment process.

This affidavit is made in support of defendant's motion in opposition to plaintiff's motion for summary judgment.

OLIVER BOWLES

Sworn to before me this 9 day of July, 1956.

W E HOUSE

(SEAL) My Commission Expires January 31, 1960.

DISTRICT OF COLUMBIA : SS.:

Darrell S. Parker, of the County of Arlington, Virginia, deposes as follows:

1. I received the degree of Bachelor of Science in Mechanical Engineering at Case Institute of Technology, Cleveland, Ohio. I also took post-graduate courses at Ohio State and Ohio Universities.

2. I am a Registered Professional Engineer in the State of Ohio (Number 7724). I am a member of the National Society of Professional Engineers, the District of Columbia Society of Professional Engineers, Inc., The American Society of Mechanical Engineers, and The American Society of Appraisers.

3. I have had cement mill experience as a foreman and engineer with the Bessemer Limestone & Cement Company, Bessemer, Pennsylvania, from September, 1921, to December, 1922. I was an engineer (design) with the Clinchfield Portland Cement Corporation, Kingsport, Tennessee, (now Penn-Dixie Cement Corporation) from February, 1924, to February, 1925. I was an assistant superintendent with the Peerless Cement Corporation, Detroit, Michigan, from March, 1925, to September, 1925. I was

an engineer in design and construction with the Lone Star Cement Corporation, New York, New York, from September, 1925, to April, 1931. I was a project engineer with the Diamond Alkali Company, Painesville, Ohio, (Standard Portland Cement Division) from March, 1934, to March, 1935, and from April, 1936, to March, 1937. I was an engineer with the Lehigh Portland Cement Company, Allentown, Pennsylvania, for a short period in 1938, and an engineer on design and construction with the Penn-Dixie Cement Corporation, Nazareth, Pennsylvania, from October, 1939, to September, 1940. I have been with the Internal Revenue Service, United States Treasury Department since September, 1940. My present position is Chief, Appraisal Section, Engineering and Valuation Branch, Special Technical Services Division.

4. Cement rock is the raw material used in the manufacture of Portland Cement. Due to the desire to obtain certain proper chemical constituents there is often added clay, shale or slag. Slag is a waste product obtained primarily from blast furnaces in the production of iron and steel. In some instances sand or marl sandstone is added as a supplement.

5. Other products from which Portland Cement may be manufactured include marl, oyster shells, also a waste product resulting from the manufacture of soda ash. By oyster shells I mean shells which are primarily obtained from the sea.

6. The raw materials are first crushed and the proper mixture obtained. They are then either reduced initially in a primary grinding mill such as a tube or ball mill. At this time in the wet process water is added and the resulting product which is discharged from the tube or ball bin is called "slurry". The water so added is only used to assist in the grinding and handling of the raw material. Furthermore, the wet process eliminates the dust problem which is more or less prevalent in the dry process. The

slurry is then usually stored and continually mixed in storage tanks, from which the slurry is fed to the rotary filters which substantially reduce the water content.

7. The filter cake is next fed into the feed end of large long rotary kilns. In the dry process after the proper mixture has been obtained, by grinding and then blending in the storage tanks after the tube mill, the dry mix is fed directly into the feed end of the kilns.

8. All the processes prior and up to the point of introducing the filter cake or the dry raw mix into the kilns involve solely the preparation of the minerals without any change in chemical content. Up to such point no change has occurred in the minerals mined except in the nature of particle size. The addition of clay, marl or similar materials to the limestone rock produces no change in the natural minerals. All of the processes to this point are outlined in paragraph 9(a) and (b) of the Stipulation of Facts of this proceeding.

9. After the slurry or raw mix is introduced into the rotary kiln there is a definite change in the chemical content. This change starts about one-third of the distance into the kiln and at two-thirds way the major chemical reactions occur. The "clinker" as it is known after it is discharged from the kiln is a mixture of synthetic compounds. The more important of these are tricalcium silicate, tetracalcium aluminoferrite, tricalcium aluminate, and dicalcium silicate. None of these chemical compounds exist in the raw slurry or mix.

10. The clinker upon its discharge from the kiln is cooled and is then conveyed to storage after which it is fed into a ball or tube mill for its final grinding. At the time the clinker is fed into the tube or ball mill a small percentage of gypsum is added. The purpose of the addition of the gypsum is to retard the hydration of the cement when it is used in construction work. After the clinker and gyp-

sum are cooled the resulting product is then known as Portland Cement and it is then conveyed to storage bins for later shipment in bags or in bulk. The above processes from the point of the kiln to the bagging or bulk loading of the finished cement are the processes described in paragraph 10 of the Stipulation of Facts. These are not ordinary treatment processes known to the mining industry as preparation of the raw minerals but are essentially manufacturing or synthetic creation of new matter not found in the earth.

This affidavit is made in support of defendant's motion in opposition to plaintiff's motion for summary judgment.

DARRELL S. PARKER

Sworn to before me this 13 day of July, 1956.

W E HOUSE
Notary Public

(SEAL) My Commission Expires January 31, 1960.

June 19, 1956.

To Whom it May Concern:

This is to certify that the records of the Office of the District Director, Lower Manhattan, reflect the following, relative to the filing of the 1954 corporation income tax return of Dragon Cement Company, Inc., 150 Broadway, New York 38, New York.

1. That taxpayer on March 15, 1955, filed a tentative return on Form 7004, for the year 1954, under Revenue Ruling 54-86 (C.B. 1954-1, page 79) disclosing a tentative tax liability of $1,120,000. A check for $560,000, 50 per cent of the estimated tax liability, accompanied the tentative return. The tentative return did not disclose net income figures and did not reflect any deduction as an allowance for depletion claimed.

2. On June 3, 1955, in reply to a request dated June 1, 1955, the taxpayer was granted a further extension of time to September 15, 1955 within which to file corporation income tax return for the year 1954.
3. On June 15, 1955, check for $560,000, balance of tentative tax liability of $1,120,000, received.
4. On September 14, 1955, the taxpayer filed a final return for the year 1954 disclosing a net income of $1,099,549.00 and a tax liability of $560,791.00. This return reflected an overpayment in the amount of $559,209.00 which the taxpayer requested be returned.
5. In accordance with standard administrative procedure an overpayment was scheduled for refund on Washington Schedule No. IT-187103, after comptometer check of the arithmetical accuracy of the figures reflected on page 1 of the return, items 1 through 38, the tax computation reflected on page 3 of the return, items 7 through 11 and the Alternative Tax Computation, Schedule D, items 11 through 20.
6. A final audit of the taxpayer's return had not been made nor had any consideration been given to the merits of the claimed deduction for percentage depletion, item 26, page 1 of the return.

JESSE O. SCHAEFER
Acting District Director of Internal Revenue
Lower Manhattan District of New York

Subscribed and sworn to before me this 19th day of June 1956.

JOHN W. ENFIELD
John W. Enfield
Notary Public, State of New York
Qualified in Suffolk Co. No. 52-1115500
Cert. filed with N. Y. Co. Clk's Office
Term Expires March 30, 1957

Stipulation.

[Filed August 15, 1956.]

It is hereby stipulated by and between the attorneys for the respective parties that, for the convenience of the parties, the oral argument on the Plaintiff's Motion for Summary Judgment filed herein May 22, 1956 shall take place before the Honorable Bailey Aldrich (designated by the Honorable Calvert Magruder, Chief Judge of the First Circuit, to sit as a District Judge for the District of Maine in the above entitled action) in the United States Court House, Boston, Massachusetts, on Thursday, August 23, 1956, at 10:00 A.M. Eastern Daylight Saving Time.

Dated: August , 1956.

HERBERT E. LOCKE
JAMES L. REID
JOSEPH B. CAMPBELL
Attorneys for Plaintiff
CLARK, CARR & ELLIS
Of counsel for Plaintiff
PETER MILLS
United States Attorney

Defendant's Cross-Motion for Summary Judgment.

[Filed August 17, 1956.]

Defendant, through its attorney, Peter Mills, United States Attorney for the District of Maine, moves the Court to enter, pursuant to Rule 56 of the Federal Rules of Civil Procedure, a summary judgment in defendant's favor dismissing plaintiff's complaint on the ground that there is no genuine issue as to any material fact and that defendant is entitled to judgment as a matter of law. This motion is based upon:

(a) The pleadings.
(b) The Stipulation of Facts heretofore filed with this Court.
(c) The affidavits attached to plaintiff's motion for summary judgment.
(d) The brief for plaintiff in support of its motion.
(e) The affidavits attached to defendant's motion in opposition to plaintiff's motion.
(f) The brief for the defendant attached hereto.

Date: August 17, 1956.

PETER MILLS
Peter Mills
United States Attorney

Date: August 17, 1956.

Plaintiff's Motion in Opposition to Defendant's Cross-Motion for Summary Judgment.

[Filed August 23, 1956.]

Comes now Dragon Cement Company, Inc., the above named plaintiff, by its attorneys, Herbert E. Locke, James L. Reid, and Joseph B. Campbell, and moves the Court to deny defendant's Cross-Motion for Summary Judgment on the ground that the pleadings filed herein, the Stipulation of Facts filed herein and the affidavits heretofore filed by plaintiff on May 22, 1956 show that the plaintiff is entitled to judgment as a matter of law.

HERBERT E. LOCKE
Herbert E. Locke
JAMES L. REID
James L. Reid
JOSEPH B. CAMPBELL
Joseph B. Campbell
Attorneys for Plaintiff.

Opinion [as Amended].

August 24, 1956

ALDRICH, D. J.

This is an action for recovery of 1951 income taxes. All the facts appear by stipulation and undisputed affidavits, on which both parties move for summary judgment. The parties agree that one motion or the other should be granted. There are no procedural questions, but two of substance.

The first question relates to the base, which affects the amount claimable as a deduction, for depletion. Plaintiff, at Thomaston, Maine, and Northampton, Pennsylvania, mines calcium carbonate, otherwise known as cement rock, which it treats, by heat and otherwise, to convert to cement clinkers, so-called, and then grinds into powdered cement, which it packages and sells. Cement rock is a mineral. Conversion into cement clinkers involves a chemical action. Cement is a synthetic and not a natural product.

The statute requires a "reasonable allowance for depletion." 1939 I.R.C. §23(m). One permissible manner of calculation is the percentage method. The applicable provisions of Section 114 of the Code, as then amended, provided, in part, as follows:

> "(A) *In general.*—The allowance for depletion under Section 23 (m) in the case of the following mines and other natural deposits shall be . . .
>
> "(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates and magnesium carbonites, 10 per centum
>
> "(iv) . . . of the gross income from the property during the taxable year . . .
>
> "(B) *Definition of gross income from property.*—As used in this paragraph the term 'gross income from the property' as used herein shall be considered to in-

clude not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products . . ." [1]

The government contends that mining terminated, and that the depletion base was arrived at, when taxpayer had prepared the cement rock for conversion, and that the subsequent process, during which it ceased to be a mineral, was merely manufacture. This position, admittedly, is fully supported by administrative rulings. Treas. Reg.

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1. This section continued as follows:
"and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores . . ."

111, Sec. 29.21 (m)-1(f). Taxpayer contends this regulation is invalid because the portion of §114(B) quoted above in the body of the opinion does not permit such an interpretation, but, on the contrary, compels the opposite result. In this connection certain additional facts are relevant. Except in negligible amounts, which may be disregarded, cf. Cherokee Brick & Tile Co. v. United States, D.C.M.D.Ga., 122 F.Supp. 59, aff'd 218 F.2d 424, there is no commercial market for cement rock. The first commercially marketable product is cement.[2] The methods used by taxpayer to transform cement rock into cement are admitted to be the "ordinary treatment processes normally applied by mine owners or operators" who produce cement. Taxpayer asserts, in the light of that portion of §114(B) above-quoted, that this is all there is to it; that the fact that with respect to certain ores, which cement rock is not, the act provides that "mining" may stop short of reduction to a commercially marketable product does not contradict the fact that with respect to minerals, which cement rock is, the act, so taxpayer says, specifically provides otherwise.

Under the statute the only "ordinary treatment processes" that can be considered are those which produce the "commercially marketable mineral product or products." The question, therefore, is, what is the meaning, or is there more than one meaning, to this phrase, "commercially marketable mineral product?" The government argues that the taxpayer is construing it as if the third word were omitted—that a synthetic material cannot be a *mineral* product. Taxpayer argues that a synthetic material can be the *product* of a mineral, even though it is not itself a mineral. Putting this another way, is the word mineral used in the statute as a noun, or as an adjective?

2. There seems to be some haziness as to whether a market exists for cement in clinker form, or only when ground to powder, but if that matter is open it does not affect the present question of which party's motion should prevail.

It seems to me that both possibilities can, semantically, be correct,—that the matter is one of emphasis, the resolution of which depends upon the context. In a garage which advertises "petroleum products," one would expect to find gasoline and lubricating oils, which are petroleum products, not petroleum. But in a road-side store advertising "wood products" one would hardly look for turpentine and methyl alcohol. In the first instance the understood emphasis is on the product; in the second, on the wood.

The question here is, may a depletion allowance extend to a product of a mineral, although it is itself non-mineral (viz, a commercially marketable mineral *product*), or is it to be restricted to products still in a mineral state, (viz, a commercially marketable *mineral* product)? The answer should depend upon the general context and purpose. Since depletion relates to mining and not to manufacturing, I believe the emphasis must here be upon the word "mineral", as a noun. This seems both reasonable and in accordance with such affirmative statutory and administrative history as appears. Accordingly, I hold that chemical conversion, by the addition of other material and the application of heat, has passed beyond mining, to which the concept of depletion is apposite, to manufacturing, where it is not.

The fact that in a particular mining operation there may, as in this case, not be any commercial market for the mineral, but only for the product manufactured from it, should not change the general meaning of the statute. Plaintiff's position would require the phrase to be interpreted "commercially marketable *mineral* product" when there was a commercially marketable mineral, and "commercially marketable mineral *product*" when there was not. This, paradoxically, would mean that the less valuable the mineral is itself, the greater the amount of the depletion allowance. It would be difficult to escape the conclusion that if cement

rock mined in Thomaston, Maine, was not commercially marketable, but if mined in Northampton, Pennsylvania it was,[3] plaintiff would be entitled to a more favorable depletion base in Thomaston than in Northampton. This would resemble subsidy, not depletion, a result not to be reached unless the language compels it.

Taxpayer cites United States v. Cherokee Brick & Tile Co., 5 Cir., 218 F.2d 424. The government seeks to distinguish that case on the ground that it did not affirmatively appear, and the court did not consider that baking the clay to produce brick changed it from a mineral to a synthetic material.[4] However, I prefer to say, with all due respect to the court therein, that I consider it illogical, unless absolutely necessary, to base a mining depletion allowance on what was, presumably, relatively plentiful and inexpensive cl upon the cost of what was, presumably a relatively expensive process of manufacturing it into tiles and brick.[5] That result followed from the court's construing the act as unambiguously so providing. For reasons already stated I do not agree. Instead, consideration of the statute leads me to believe that its extension of the dictionary definition of mining was merely to cover incidentals, not to affect such changes of substance. Consequently, where there is no commercially marketable *mineral* product, as above defined, depletion must be mathematically calculated and

3. One of the reasons given for non-marketability herein is transportation expense.

4. In Hitchcock Corp. v. Townsend, 4 Cir., 234 F.2d, aff'g 132 F.Supp. 785, New Idria Quicksilver Mining Co. v. Com'r, 9 Cir., 141 F.2d 918, and International Talc Co., 15 T.C. 981, cases also relied on by plaintiff, it clearly appeared that the product was changed only in form, and remained a mineral or ore. Hence this question of construction could not arise.

5. In the case at bar four times as much "depletion" would be allowable if the process of conversion into cement could be included.

computed, as it has long been done with respect to other materials, and as was done here prior to the claim for refund.

The second question requires a further statement. The plaintiff is a Maine corporation. During the 1920's the Lawrence Portland Cement Company, a Pennsylvania corporation, paid to the Commonwealth of Pennsylvania the sum of $12,000 as a capital stock bonus, required to be paid when it increased its stated capital, or issued authorized capital stock. This was a capital expenditure, Commonwealth v. Erie & Western Transportation Co., 107 Pa. 112, not deductible for federal income tax purposes when paid. United Gas Co. v. Burnet, 3 Cir., 64 F.2d 957. In 1951 Lawrence Portland Cement Company was merged into the plaintiff, which resulted in the disappearance of the Pennsylvania corporation as such. All rights acquired by the so-called capital stock bonus accordingly ceased. Plaintiff, who succeeded to the rights and liabilities of that corporation, claims a $12,000 loss. It has been held that the termination of such rights by a total dissolution of a corporation is a deductible tax loss. Malta Temple Association, 16 B.T.A. 409; Pacific Coast Biscuit Co., 32 B.T.A. 39. The government expressly acquiesces in that view, but argues that there is a distinction between termination by dissolution and by merger. I do not agree. In confirmation of plaintiff's position its evidence, which I took indicates that substantially this bonus had to be paid over again to the Commonwealth of Pennsylvania immediately after the merger.[6] Cf. Petry v. Harwood Electric Co., 280 Pa. 142.

It follows that the defendant is entitled to a partial summary judgment of dismissal as to the depletion claim, and the plaintiff to a partial summary judgment in its favor as

6. This payment was something less than $12,000, and perhaps the loss, accordingly, was that lesser figure, but I am not concerned with that on this motion.

to the capital stock bonus loss. Formal order to be submitted.

ALDRICH

U.S.D.J.

Judgment as Amended.

[September 24, 1956; October 19, 1956.]

This cause came on to be heard on motion of plaintiff for Summary Judgment for the relief demanded in the complaint and cross-motion of defendant for dismissal of the complaint and it appearing to the Court that there is no genuine issue as to any material fact and that plaintiff is entitled as a matter of law, it is hereby

ORDERED, ADJUDGED and DECREED that:

1. Plaintiff recover of defendant the sum of [$10,546.46],* together with interest thereon, as provided by law; and

2. That plaintiff take nothing further in consequence of plaintiff's complaint as to the issue of percentage depletion and as to that issue, the action be and it is hereby dismissed on the merits.

BAILEY ALDRICH

9/24/56 D. J.

Notice of Appeal.

[Filed October 22, 1956.]

Pursuant to Rule 73(a), (b) and (c) of the Rules of Civil Procedure, notice is hereby given this 19th day of October, 1956, that Dragon Cement Company, Inc., plaintiff abovenamed, hereby appeals to the United States Court of Appeals for the First Circuit from that portion of the final

*By amendment (Aldrich, D.J., October 19, 1956).

judgment entered in this action on the 24th day of September, 1956 in favor of the United States of America, defendant above-named, against said Dragon Cement Company, Inc., which provides:

> "(1) That defendant is entitled to judgment, as a matter of law on the first issue, relating to the computation of the plaintiff's deduction for percentage depletion; . . . . .
>
> It is ordered
>
> . . . . .
>
> As to the first issue, that Summary Judgment be entered in favor of defendant, that plaintiff take nothing."

HERBERT E. LOCKE,
Attorney for Plaintiff
Depositors Trust Building
Augusta, Maine

Of Counsel:

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RECORD APPENDIX

United States District Court for the District of Maine, Southern Division

Civil Action No. 4–90

DRAGON CEMENT COMPANY, INC., PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

Complaint

[Filed August 29, 1955]

* * * * *

42

By letter dated November 10, 1953, addressed to the American Mining Congress by Ralph S. Gayton, then Director, Special Technical Services Division, the then Bureau of Internal Revenue recognized that it is not customary in the industry to sell quantities of cement rock prior to processing said cement rock into cement and that, for this reason, there was no representative field price for the cement rock mine by the taxpayer at any stage of processing before cement. Said letter dated November 10, 1953 stated that in the absence of such an established field price, it was necessary to resort to the "proportionate profits" method to determine an artificial field price for the cement rock at the kiln feed stage (sub-paragraph (j) of paragraph 28 *supra*), which artificial field price is used to determine "gross income from mining."

In applying the "proportionate profits" method of computing "gross income from mining," it is assumed that each step in the processing of cement rock mined by the taxpayer produces the same relative profit. Therefore, the cost of bringing the cement rock to the kiln feed stage (sub-paragraph

(j) of paragraph 28 *supra*), plus a proportionate share of the profit margin, is computed as the "gross income from mining" the cement rock.

The proportionate share of the profit margin allocable to the cement rock at the kiln feed stage was determined on the ratio of the cost of the processing operations to that point to the total cost of the entire processing of cement rock into cement.

Pursuant to said letter of May 16, 1952, the invalid Revenue Ruling 290 and said letter dated November 10, 1953, Lawrence Portland Cement Company computed its percentage depletion deduction allowable for the taxable period on a basis generally as follows except that pursuant to the applicable regulations said computations were computed separately for each plant and except that minor changes were made in the figures by the examining Revenue Agent, which are reflected below:

(1) Gross income from cement sales		$9,303,547
(2) Total costs	$6,916,629	
(3) Costs to kiln feed stage	2,369,054	
(4) Percentage (3) to (2) (34.252%) per revenue agent's report		34.412%
(5) Gross income to kiln feed stage per revenue agent's report (1) x (4)		3,201,537
(6) Direct costs, all materials, plus depreciation and overhead to kiln feed stage	1,959,375	
(7) Direct costs plus depreciation and overhead, cement rock only, to kiln feed stage	1,261,174	
(8) Percentage (7) to (6) (64.366%) per revenue agent's report		63.987%
(9) Gross income from mining cement rock per revenue agent's report (5) x (8)		2,048,567
(10) Percentage depletion allowable (10% of (9))		204,857

The said letter dated November 10, 1953 repeated the error of said invalid Revenue Ruling 290 and of said letter dated May 16, 1952 in that it failed to include the kiln and post-kiln processes (sub-paragraphs (k), (l), and (m) of paragraph 28 *supra*) as "ordinary treatment processes" to obtain the "first commercially marketable mineral product" in the computation of "gross income from mining". Pursuant to the provisions of Section 114 (b) (4) (B) of the Internal Revenue Code of 1939, the processes described in sub-paragraphs (k), (l), and (m) of paragraph 28 *supra* should have been included in such

computation. Had the Lawrence Portland Cement Company correctly computed the percentage depletion deduction allowable for the taxable period by including the said processes described in sub-paragraphs (k), (l) and (m) of paragraph 28 *supra*, "gross income from mining" would have been determined on the percentage of tons of material mined to tons of material handled, rather than on an allocation of dollar profits. Such computation would have been as follows (The effect of separate computations for each plant is indicated.):

(1) Gross income from cement sales	$9,303,547	
(2) Gross income from bag sales	503,402	
(3) Gross income for purposes of percentage depletion		$9,806,949
(4) Material handled—1,017,991 tons		
(5) Mined cement rock—824,093 tons		
(6) Purchased material—193,898 tons		
(7) Percentage (5) to (4) (80.953%) adjusted for detailed computation by plants		81.152%
(8) Gross income from cement rock mined (7) × (3)		7,958,535
(9) Percentage depletion allowable (10% of (8))		795,853

It should be noted that the percentage depletion deduction cannot exceed 50% of taxable income from the property. Since this limitation was not operative here it was not included in the above computations.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1957

No. 301

JUL 1 1957
JOHN T. FEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1957

UNITED STATES OF AMERICA, *Petitioner*

v.

DRAGON CEMENT COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

HERBERT BROWNELL, JR.,
Attorney General,

JOHN N. STULL,
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Attorney General,

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Statute and regulations involved	2
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CITATIONS

CASE:

United States v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 . . 5

STATUTE:

Internal Revenue Code of 1939:

Sec. 23(m) (26 U.S.C. 1952 ed., Sec. 23(m)) 5, 15

Sec. 23(n) (26 U.S.C. 1952 ed., Sec. 23(n)) 5, 15

Sec. 114(b) (26 U.S.C. 1952 ed., Sec. 114(b)) 5, 15a

MISCELLANEOUS:

Treasury Regulations 111, Sec. 29.23(m)-1 . . . . . 17a

In the Supreme Court of the United States

OCTOBER TERM, 1957

No.

UNITED STATES OF AMERICA, *Petitioner*

v.

DRAGON CEMENT COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

The Attorney General,[1] on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the First Circuit in the above-entitled case.

OPINIONS BELOW

The opinion of the District Court (R. A39-A45)[2] is reported at 144 F. Supp. 188. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-14a) is not yet officially reported.

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[1] For personal reasons, the Solicitor General has disqualified himself from participating in this litigation.

[2] "R." refers to the Appendix to the Brief for Plaintiff-Appellant, and "Supp. R." to the Appendix to the Brief for Defendant-Appellee.

JURISDICTION

The judgment of the Court of Appeals was entered on May 14, 1957. (Appendix A, *infra*, p. 14a.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether "gross income from mining", on the basis of which percentage depletion for mineral deposits is allowable under Sections 23(m) and (n) and 114 (b)(4) of the Internal Revenue Code of 1939, includes income derived from manufacturing merely because the mine owner, in addition to engaging in mining activities, transforms the mineral into a manufactured product and sells it as such.

The answer depends on whether the mine owner's manufacturing operations are to be considered "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product", within the meaning of Section 114(b)(4)(B).

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Sections 23(m) and (n) and 114(b)(4) of the Internal Revenue Code of 1939 and of Section 29.23(m)-1 of Treasury Regulations 111 are set forth in Appendix B, *infra*, pp. 15a-22a.

STATEMENT

Taxpayer[3] owns and operates two quarries from which it extracts a calcium carbonate rock, commonly

[3] The Dragon Cement Company, Inc., by a merger effective November 30, 1951, became the successor to the Lawrence Portland Cement Company. (R. A17.) For convenience, the predecessor and successor corporations are referred to as the "taxpayer".

known as cement rock, suitable for conversion into cement. Its operations begin with drilling and primary blasting from the face of the quarry to obtain the mineral product, cement rock. The cement rock is then broken into manageable size by secondary blasting and loaded by shovels into dump trucks, which carry the cement rock to an inclined railway. It is there deposited into dump rail cars for transportation to the plant. The cars, in turn, dump the cement rock into a large primary crusher, which reduces the size of the extracted rock to pieces of a maximum dimension of about eight inches. After primary crushing, the crushed cement rock is carried by a conveyer belt to a secondary crusher which further reduces the size of the rock. A conveyor belt then carries the cement rock to a shed. At this point, the rock is picked up by an overhead crane and deposited in a hopper for screening. The screened cement rock is then fed to a ball mill, where it is ground with water to a proper fineness known as "slurry". The material is then conveyed to a wet "slurry" tank where it is kept in suspension by a revolving paddle mechanism. The "slurry" is next run off to filters, where much of the water is removed, and the resulting filter cake is conveyed by belt to rotary kilns. The filter cake is then placed in the upper end of the kilns, which take the form of long rotating cylinders set at a slight inclination, the filter cake gradually traveling to the lower end of the kiln. Hot gases from a flame at the lower end draw off water from the filter cake and burn the remaining material to a dense clinker. The clinker is carried to a grinding mill where it is ground to the fineness of cement. Finally, the cement is placed in

silos from which it is loaded and shipped in bags or in bulk. (R. A18-A20.)

In its return for the taxable period ending November 30, 1954, taxpayer computed its deduction for depletion of the mineral deposit by applying the statutory percentage (10% on cement rock) to that portion of the gross income realized from the sale of the finished cement product which was allocable to its mining, as distinguished from its manufacturing, operations.[4] However, taxpayer subsequently filed a claim for refund, alleging that it should have computed the percentage depletion deduction in its return on the basis of the total sales price of the finished product, without diminution for the portion attributable to its manufacturing (*i.e.*, the kiln and post-kiln) processes.[5] (Supp. R. 51-53.) The claim was denied, and suit for refund followed. (R. A4-A14, A18.) The District

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[4] The allocation was made by obtaining the percentage resulting from dividing the cost incurred up to the kiln-feed stage by the total cost, and multiplying the gross income from cement sales by this percentage. Since taxpayer used certain purchased materials in its end product (in addition to the cement rock it mined), the allocated gross income was then multiplied by the percentage obtained by dividing the direct costs applicable to cement rock only (plus depreciation and overhead) to the kiln-feed stage by the direct cost of all materials (plus depreciation and overhead) to the kiln-feed stage in order to obtain the gross income from mining the cement rock. The resulting figure was then multiplied by the applicable statutory percentage (10%) to obtain a depletion allowance of $204,857. (Supp. R. 51-53.)

[5] Taxpayer's refund claim was based on a depletion allowance computed as follows: the gross income from cement sales was multiplied by the percentage obtained by dividing the tonnage of cement rock mined by the tonnage of all material handled, in order to obtain gross income from cement rock mined, to which taxpayer applied the applicable percentage to obtain a claimed allowance of $795,853. (Supp. R. 51-53.)

Court, on cross motions for summary judgment, dismissed the complaint and entered judgment as to this issue in favor of the United States. (R. A45.) The Court of Appeals reversed. (Appendix A, *infra*, pp. 1a-14a.)

REASONS FOR GRANTING THE WRIT

This case presents the same important question of statutory construction as *United States* v. *Merry Brothers Brick and Tile Co., et al.*, No. 220, in which a petition for a writ of certiorari was filed on June 24, 1957, namely, the proper basis for computing percentage depletion for mineral deposits under Sections 23(m) and (n) and 114(b)(4) of the Internal Revenue Code of 1939. (Appendix B, *infra*, pp. 15a-17a.) While the *Merry* and companion cases involve clay, and the instant case involves a calcium carbonate (cement rock), the problem is the same, and it was so considered by the court below. Indeed, in holding that "gross income from mining"—the base, under the statute, to which percentage depletion is applicable—extends to income derived from manufacturing operations, the court below expressly followed the interpretation placed on the statute by the Fifth Circuit in *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (Appendix A, *infra*, pp. 10a-11a). The views adopted in *Cherokee* were reaffirmed by the Fifth Circuit in the *Merry* case.

For the reasons set forth in our petition in the *Merry* and companion cases, we submit that the decision below, which rejected the Treasury's long-standing interpretation of the statute, is erroneous. The *Cherokee* rule, if it prevails, will have heavy impact

upon the revenue.[6] The same considerations which call for review of the Fifth Circuit cases now pending on petition (No. 229) make the instant case an equally appropriate one for grant of the writ.

Respectfully submitted,

HERBERT BROWNELL, JR.,
*Attorney General.**

JOHN N. STULL,
Acting Assistant
Attorney General.

HARRY BAUM,
SHELDON I. FINK,
Attorneys.

JULY 1957.

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[6] A survey conducted by the Internal Revenue Service (see Appendix C to the *Merry* petition) indicates that there are numerous cases now in litigation or pending administratively, involving percentage depletion allowable with respect to calcium carbonates and other minerals, in which mine owners are attempting to apply the rule followed by the court below; and that the tax loss which would result from application of the rule is very substantial.

* See footnote 1, *supra*.

APPENDIX A

Opinion and Judgment Below

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 5186

DRAGON CEMENT COMPANY, INC., *Plaintiff, Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant, Appellee.*

Appeal from the United States District Court
for the District of Maine

[144 F. Supp. 188]

Before MAGRUDER, *Chief Judge,* and WOODBURY and HARTIGAN, *Circuit Judges*

Opinion of the Court

May 14, 1957

MAGRUDER, *Chief Judge.* Appellant, a Maine corporation, in its capacity as successor (by merger effective November 30, 1951) to Lawrence Portland Cement Company, a Pennsylvania corporation, brought this action in the United States District Court for the District of Maine seeking recovery of federal income and excess profits taxes for the period January 1 to November 30, 1951, in the amount of $483,522.19, with interest. The facts were not in dispute and were recited in a stipulation. Both parties having moved for summary judgment, the district court on September 24, 1956, entered a judgment the first paragraph of which (as subsequently amended) decreed that the plaintiff recover of the defendant the sum of $10,546.46, with interest, on account of a deductible tax loss under § 23(f) of the Internal Revenue Code of 1939, an issue which is no longer in the case, and the second paragraph of which decreed as follows:

"2. That plaintiff take nothing further in consequence of plaintiff's complaint as to the issue of percentage depletion and as to that issue, the action be and it is hereby dismissed on the merits."

The taxpayer has appealed from that portion of the judgment denying recovery to it under the percentage depletion issue, so that the case now before us turns solely on a question of statutory interpretation of § 114(b)(4)(B) of the 1939 Code, as amended, which defines the term "gross income from mining" for use in determining the basis for percentage depletion allowed as a deduction from income derived from certain mines and natural mineral deposits.

The allowance for depletion has been a controversial subject for years, and officials of the executive branch have sought from time to time, with conspicuous lack of success, to persuade the Congress to eliminate some of its alleged overgenerous features. See Mertens, Law of Federal Income Taxation § 24.04 (1954). We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it.

The need for and fairness of some allowance for depletion proceeds from the fact that the production of income through the exploitation of natural resources is accompanied by an inevitable consumption of capital in the form of the gradual exhaustion of the natural resource being exploited. Thus the allowance serves to offset the injustice of classifying only as income what might be regarded as income commingled with return of capital, and serves also as an incentive to encourage capital expenditures in the direction of discovery and exploitation of natural resources.

Of the three types of depletion allowance prescribed at various times by the Congress, percentage depletion (with which we are now concerned) is to be con-

trasted with cost depletion and discovery depletion. Cost depletion, based upon the cost to the taxpayer of the particular deposit, seeks to return to the taxpayer free of tax that portion of his cost attributable to the amount of the deposit used up in earning the income on which he is taxed during a given taxable year. Discovery depletion seeks to reward the taxpayer for the discovery of unknown natural deposits, and has usually been based upon the fair market value of the deposit within thirty days after the date of its discovery. By the third type of depletion allowance, percentage depletion, the Congress hoped to furnish an easily computable allowance that would avoid many of the complications arising in connection with the computation of cost or discovery depletion. Percentage depletion is based upon a fixed percentage of the income realized during the taxable year from the exploitation of a piece of property—the percentage varying, somewhat arbitrarily, depending upon the kind of deposit involved.

With the gradual enlargement of the categories of mineral properties to which the percentage depletion became applicable, the Congress has at the same time automatically eliminated discovery depletion in respect to such deposits.[1] In general, percentage depletion has remained as an alternative to cost depletion, so that even if the taxpayer fails to establish the cost of the property, he nevertheless may be entitled to the allowance of a percentage depletion. It is also true, as pointed out in Mertens, Law of Federal Income Taxation § 24.31*a* (1954), "that through percentage depletion a taxpayer may recover more than his cost over the life of the property."

For present purposes we need go no further back than to the provisions of the Internal Revenue Code of 1939.

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[1] The 1954 Code has now abolished discovery depletion entirely as applied to future years.

Section 23 of this Code contained the following (53 Stat. 12, 14):

"Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions: . . .

(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . .

(n) Basis for Depreciation and Depletion.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114."

Section 114(b)(1) stated as the general rule (53 Stat. 45) that the basis for the depletion allowance should be the adjusted basis in § 113(b) for determining gain upon the sale or other disposition of such property, except as otherwise provided in the ensuing paragraphs numbered (2), (3), and (4). Paragraph (2) related to discovery value in the case of certain mines. Paragraph (3) gave a percentage depletion formula for oil and gas wells. Paragraph (4) gave percentage depletion formulas for coal, metal, and sulphur mines (but not including the type of deposit involved in the case at bar), and provided allowances based upon a prescribed percentage of the "gross income from the property during the taxable year".

The phrase "gross income from the property" was undefined as it appeared in the 1939 Code. It thus had a lurking ambiguity where the mine owner customarily performed more than merely extractive op-

erations before realizing any income; in such cases, would the basis for the depletion allowance include gross income from what in other contexts might be described as manufacturing operations upon the extracted property? The statute did not make this point clear, and Regulations 111, as originally issued, naturally sought to narrow the scope of the allowance.

In the Revenue Act of 1943 (58 Stat. 45), the Congress attempted to resolve this ambiguity by inserting a definition of "gross income from the property" in a new § 114(b)(4)(B), reading in part as follows:

> "(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentation (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leading, crystallization, precipitation (but not including as an ordinary treatment process electrolytic dep-

osition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores."

It is apparent that the Congress intended not to limit the computation of the percentage depletion allowance to the gross income attributable to purely extractive processes, for the deposit when thus first extracted might not be in a commercially marketable form, and might require further processing. Congress accomplished this by providing for the first time a general formula, and by giving nonexclusive illustrations of processes included in the phrase "ordinary treatment processes". See § 3797(b) of the Code of 1939, 53 Stat. 470. The general formula, which of course is controlling, is that the basis for computing the percentage depletion allowance shall be the "gross income from mining", defined as including "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Thus we must look to see what processing is normally undertaken by a mine owner or operator in order to obtain a commercially marketable product, and when such a salable product is obtained, then the gross income from the sale of such product is the base upon which to apply the percentage depletion allowance. That these "ordinary treatment processes" are not necessarily limited to those processes which leave the extracted deposit in its natural state is clear from the inclusion, as an illustration in § 114(b)(4)(B), of the process of furnacing quicksilver ores, which involves a chemical change.

It would also be helpful, in a preliminary way, to observe that the depletion allowance is not an allowance upon any *process*, whether a mining process or a

manufacturing process. Nor is it an allowance, as such, upon any product. Instead, it is an allowance to the mine owner designed as a simple means to diminish his taxable income from the exploitation of a natural resource which is necessarily exhausted in the process. In making this allowance, the Congress has elected not to limit the deduction in all cases to the taxpayer's actual cost or other basis in the land from which the ore or mineral is extracted. To supply a simpler rule, the Congress has turned more and more to the method of percentage depletion, which differs from both cost and discovery value depletion in that it is measured by an arbitrary percentage of gross income from the property, without regard to the taxpayer's cost or discovery value.

From the foregoing it is clear that by the enactment of 1943 the Congress for the first time introduced into the statute key language which had not theretofore appeared either in the statute or in the regulations thereunder, namely, a new definition of "gross income from mining" as including "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Notwithstanding this, the Commissioner has subsequently sought, by regulatory amendments to § 29.23 (m)-1(f) of Treas. Reg. 111, in cases where the mine owner customarily had to indulge in further processing other than merely extractive operations before obtaining a commercially marketable product upon which he could realize any income, to prescribe a relatively complex mathematical method for calculating the percentage depletion base. This would require an allocation of income derived from the sale of the first marketable product to the various treatment processes in proportion to their cost, with only those processes allowed as part of the base which occurred before any chemical change had taken place in the extracted mineral.

By § 319 of the Revenue Act of 1951 (65 Stat. 497), the Congress amended § 114(b)(4)(A) of the Internal Revenue Code so as to extend the availability of percentage depletion for the first time to "calcium carbonates," which includes deposits of cement rock, the natural resource involved in the case at bar. The prescribed percentage for calcium carbonates was ten per cent of the gross income from mining the deposit.

With the foregoing stated by way of background, it will perhaps be easier to understand the significance of the facts in the present case.

Throughout the tax period in question, Lawrence Portland Cement Company, the taxpayer-appellant's predecessor, owned and operated two quarries, one in Maine and the other in Pennsylvania, from which it extracted cement rock, a calcium carbonate suitable for conversion into cement. The operations began with drilling and primary blasting from the face of the quarry by the open pit method to obtain the cement rock, which was then broken into manageable size by secondary blasting and loaded by shovels into dump trucks which carried it to an inclined railway where it was deposited into dump rail cars for transportation to the near-by plant.

Treatment or "beneficiation" then occurred at the plant in the following processes: The dump rail cars deposited the cement rock into a large primary crusher, which reduced the size of the extracted rock to pieces with a maximum dimension of about eight inches. After this primary crushing, the cement rock fell onto a conveyor belt which carried it to a secondary crusher which further reduced the size of the rock. From the secondary crusher a conveyor belt carried the cement rock to a shed, from which it was picked up by an overhead crane which deposited the desired quantities into a hopper, over which a coarse bar grate was fitted to screen the crushed cement rock. From the hopper, the screened cement rock was gravity-fed to a ball mill where it was ground with water to a proper fine-

ness known as "slurry," which was then conveyed to a wet "slurry" tank where it was kept in suspension by a revolving paddle mechanism. The "slurry" was then run off to filters where much of the water was removed, and the resulting filter cake was thereafter conveyed by belt to rotary kilns.

There is no dispute that the gross income allocable to the operations thus far described may be included in determining the gross income from mining of the mineral, cement rock, for the purpose of calculating the base to which the allowable percentage depletion is to be applied. But it was found as a fact by the trial court, and we understand that this is not controverted by the government, that except in negligible amounts, which may be disregarded, "there is no commercial market for cement rock. The first commercially marketable product is cement. The methods used by taxpayer to transform cement rock into cement are admitted to be the 'ordinary treatment processes normally applied by mine owners or operators' who produce cement."

Accordingly, the taxpayer's predecessor had to engage in further processes before obtaining a marketable product, cement, upon which gross income could be realized. The so-called filter cake was run into the upper end of rotary kilns, which were in the form of long rotating cylinders set at slight inclination, the filter cake gradually traveling toward the lower end of the kiln. Hot gases from a flame at the lower end evaporated the water from the filter cake and burned the remaining material to a dense clinker. The clinker was then conveyed to a grinding mill where it was ground to the fineness of cement; the cement was finally placed in silos from which it was loaded and shipped in bags or in bulk. It is conceded that these last processes effected a chemical change in the cement rock, transforming it from its crude mineral state into cement, which is synthetic and not a mineral.

The dispute here involves the propriety of includ-

ing income allocable to the kiln and post-kiln processes in gross income from mining, as defined; if such processes are excluded, the depletion allowance for the taxable period would be $204,859.19, whereas, if such processes are included, the allowable depletion would be $795,852.60.

It is contended by the government that mining terminated, and that the depletion base was arrived at, when the mine operator had prepared the cement rock for conversion, and that the subsequent operations, during which it underwent a chemical change and ceased to be a mineral, constituted a manufacturing process, not allowable in computing the depletion base. As indicated above, this contention is fully supported by Treas. Reg. 111, § 29.23(m)-1(f), but the taxpayer maintains that the regulation is invalid in this respect because the definition of "gross income from mining", inserted in § 114(b)(4)(B) in 1943, does not permit such an interpretation, but on the contrary compels the opposite result. Although the district court upheld the government's view, we find ourselves in agreement with the taxpayer.

Preliminary to upholding the government's asserted interpretation, the district court concluded that the statutory language, "commercially marketable mineral product or products", was intrinsically ambiguous. One possibility, the district court said, was to construe the phrase as permitting the depletion allowance to extend to a product of a mineral, although the end product may be a synthetic non-mineral (*viz.*, a commercially marketable mineral *product*). The second possibility, said the district court, was to construe the statutory phrase as restricting the depletion allowance to products still in a mineral state (*viz.*, a commercially marketable *mineral* product).

We are unable to perceive that the statutory language contains any such inherent ambiguity. In this connection it should be observed that three other courts of appeals which have had occasion to weigh the gov-

ernment's arguments advanced in the case at bar, and to construe the critical statutory phrase, have held it to be "clear and unambiguous" in favor of the taxpayer's interpretation. See *United States* v. *Cherokee Brick & Tile Co.*, 218 F.2d 424, 425 (C.A. 5th, 1955); *Townsend* v. *The Hitchcock Corp.*, 232 F.2d 444, 446 (C.A. 4th, 1956); *United States* v. *Sapulpa Brick & Tile Corp.*, 239 F.2d 694, 697 (C.A. 10th, 1956). We are not persuaded that we ought to create a conflict with our brethren in other courts of appeals with respect to this matter.

In the first place it should be noted that cement has been consistently classified as a "mineral product" both in scholarly compilations of a general sort, such as the Encyclopedia Britannica,[2] and in publications of specialized government agencies which compile information and statistics on the mining industry. Such classification has been made by the Bureau of Mines and the Bureau of the Census, both of which had listed cement as a "mineral product" at the time the statutory definition of "gross income from property" was enacted in the Revenue Act of 1943,[3] and this classification has been continued in the latest publications of these agencies.[4]

Furthermore, it is well known that the word "mineral" is frequently used before other words to describe products which are manufactured from minerals but which are not themselves composed of minerals in the natural state. In such usage it qualifies the noun which follows and indicates mineral origin; for example, "mineral wool" is a generic term which can be applied to various insulation products manufactured

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[2] 22 Encyc. Britannica 753, Table XIII (1954).

[3] Minerals Yearbook for 1942, pp. 38, 45, 48 (1943); Statistical Abstract of the United States, 1942, p. 845. In addition, the Statistical Abstract statistics as to production of cement (pp. 879, 888) appear in a section entitled "Mining and Mineral Products."

[4] Minerals Yearbook for 1953, vol. 1, p. 20 (1956); Statistical Abstract of the United States, 1956, pp. 732, 743.

from minerals.[5] The dictionary furnishes many similar examples.[6]

The legislative history of § 114(b)(4)(B) provides additional support for the interpretation of the statutory definition which we, along with other courts of appeals, have adopted. In order to support its conclusion that cement is not a "mineral product" within the meaning of the statutory definition, the district court seized upon the word "mineral" as the crucial word in the phrase "the commercially marketable mineral product or products." However, that "mineral" is not the crucial word is made clear by the Senate Finance Committee Report which explained the meaning of the section added by that committee to the Revenue Act of 1943:

> "The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a *marketable product* should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. (Italics added.) Sen. Rep. No. 627, 78th Cong., 1st Sess., 23, 1944 Cum. Bull. 991.

In other words, although the draft of the bill to which the above report referred contained the word "mineral" and the phrase was in the same form as in the

---

[5] 9 Kirk & Othmer, Encyc. of Chemical Technology 122 (1952).

[6] *E.g.*, *mineral oil*, "Any oil of mineral origin, as petroleum, shale oil, or any oil *obtained from them by refining*"; *mineral water*, "Any water naturally or *artificially* impregnated with mineral salts or gases"; *mineral jelly*, a "semisolid substance *from petroleum* . . . used as a stabilizer in explosives"; *mineral spirits*, a "volatile petroleum product, intermediate between gasoline and kerosene, used extensively as a thinner for paints and varnishes"; *mineral rubber*, which includes "an asphalt *artificially* obtained or treated." (Italics added.) Webster's New International Dictionary, Unabridged (2d ed. 1953).

final Act, the committee did not even use the word "mineral" in explaining that the purpose of the statutory provision was to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, as defined.

Nor can we accept the government's contention that the Congress in 1943 was concerned solely with making clear that concentration processes, equivalent to those which had previously been listed in the applicable regulations, were intended to be included as a part of the mining operation, for in defining "gross income from mining" the Congress introduced new language which had never previously appeared in the history of the depletion allowance. Furthermore, the Senate Finance Committee Report which explained the provision gave no hint that Congress intended only to include such "equivalent concentration processes". Quite the contrary, as the previous quotation shows, the committee report stated that the purpose of the new provision was "to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation".[7]

For the reasons above indicated, we conclude that the taxpayer is entitled to a percentage depletion deduction based upon its gross income from cement, as the first commercially marketable mineral product obtained from the deposit, calcium carbonate, after the ordinary treatment processes normally applied by such mine owners. To the extent that § 29.23(m)-1(f) of

---

[7] It should also be observed that the government's position is subject to the anomaly that under its interpretation there never is a "commercially marketable mineral product" obtained from cement rock. Thus, to be perfectly consistent, "mining" under § 114 (b)(4)(B) would not include any "ordinary treatment processes" applied to cement rock, since mining includes only "ordinary treatment processes" applied to obtain the "commercially marketable product or products."

Treas. Reg. 111 is inconsistent with this conclusion, it must be declared to be invalid. See *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134 (1936).

A judgment will be entered vacating that portion of the judgment of the District Court now under review, and remanding the case to the District Court for further proceedings not inconsistent with this opinion.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 5186

DRAGON CEMENT COMPANY, INC., *Plaintiff, Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant, Appellee.*

Judgment

May 14, 1957

This cause came to be heard on appeal from the United States District Court for the District of Maine, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The portion of the judgment of the District Court now under review is vacated and the case is remanded to that Court for further proceedings not inconsistent with the opinion passed down this day.

By the Court:

/s/ ROGER A. STINCHFIELD
Clerk.

APPENDIX B

Statutory Provisions and Regulations

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

* * * * *

(4) [as amended by Sec. 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for * * * certain other mines and natural mineral deposits*—

(A) *In general.*—The allowance for depletion under section 23 (m) in the case of the following mines and other natural deposits shall be—

* * * * *

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

* * * * *

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would if computed without reference to this paragraph.

(B) [as added by Sec. 124 (c) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and amended by Sec. 207 (a) of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 304 (d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137] *Definition of Gross Income from Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall

include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment, (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or flourspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

* * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23 (m)-1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—

* * * * *

(f) [as amended by T.D. 5413, 1944 Cum. Bull. 124; T.D. 5458, 1945 Cum. Bull. 45; T.D. 5461, 1945 Cum. Bull. 284; T.D. 6004, 1953—1 Cum.

Bull. 45; T.D. 6031, 1953—2 Cum Bull. 120] The term "gross income from the property," as used in sections 114(b)(3) and 114 (b) (4) (A) and sections 29.23 (m)-1 to 29.23(m)-19, inclusive, means the following:

In the case of oil and gas wells, "gross income from the property" as used in section 114 (b) (3) means the amount for which the taxpayer sells the oil and gas in the immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil or gas before conversion or transportation.

In the case of a crude mineral product other than oil and gas, "gross income from the property", as used in section 114 (b) (4) (A), means the gross income from mining. The term "mining" as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. For taxable years beginning after December 31, 1949, the term "mining" as used herein also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles, and, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such

greater distance. The taxpayer shall file an original and one copy of an application for the inclusion of such greater distance in the computation of his gross income from mining with the Commissioner of Internal Revenue, Washington 25, D. C., attention of the Special Technical Services Division, Engineering and Valuation Branch. The application must include a statement setting forth in detail such facts concerning the physical and other requirements for the construction and operation of a treatment plant at a place nearer to the point of extraction from the ground as are sufficient to apprise the Commissioner of the exact basis of the application. If the taxpayer's return is filed prior to receipt of notice of the Commissioner's action upon the application, a copy of such application shall be attached to the return. If, after an application is approved by the Commissioner, there is a material change in any of the facts relied upon in such application, a new application must be submitted by the taxpayer.

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable prod-

uct resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. For a description of transportation which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and section 114 (b) (4) (B), as amended.

The term "ordinary treatment processes", as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing and loading for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of crude mineral product—sorting concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(4) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination

of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term "ordinary treatment processes". The following processes are not included in the term "ordinary treatment processes"; electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

In addition, the processes listed below are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in (1), (2), (3), or (4) above; (ii) necessary or incidental to the processes provided for in (1), (2), (3) or (4) above; or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates):

(A) treatment effecting a chemical change,

(B) blending with other material,

(C) thermal action,

(d) fine pulverization, pressing into shape, or molding.

For the purposes of (3) and (4) above, the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

For taxable years beginning before January 1, 1950, in case any of the ordinary treatment processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by the taxpayer, the proportionate profits attributable to transportation, should be subtracted from the sale price of the product to determine "gross income from the property." For taxable years beginning after December 31, 1949, in determining "gross income

from the property", the sale price of the product shall not be reduced by the costs and proportionate profits attributable to the transportation which is treated for such taxable year as mining, that is, so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles (or, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, such greater distance). Where such plants or mills are in excess of 50 miles (or of such greater distance) from the point of extraction from the ground, then costs incurred for transportation in excess of 50 miles (or of such greater distance) to the treatment plant and, if transported by the taxpayer, the proportionate profits attributable to such excess transportation should be subtracted from the sale price of the product to determine "gross income from the property". In the absence of methods which will clearly reflect costs of the various phases of transportation, the costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation to the treatment plant as the excess transportation is to such total transportation. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

* * * * *

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AUG 16 1957
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 301.

UNITED STATES OF AMERICA,

Petitioner,

v.

DRAGON CEMENT COMPANY, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 301.

UNITED STATES OF AMERICA, Petitioner;

v.

DRAGON CEMENT COMPANY, INC., Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the District Court (R. A39-A45) is reported at 144 F. Supp. 188. The opinion of the Court of Appeals is reported at 244 F. 2d 513 and attached hereto (Appendix, pp. 1a-14a).

Question Presented.

The question presented is whether all the ordinary treatment processes normally applied by miners of cement rock in order to obtain their only commercially marketable mineral product are included in the term "mining" under the Internal Revenue Code which specifically defines "mining" as including not only extraction but, in addition, those processes which are (1) normally applied by mine owners or

operators (2) in order to obtain the commercially marketable mineral product or products.[1]"

Statute Involved.

The pertinent statute, Section 114(b)(4)(B) of the Internal Revenue Code of 1939, provides:

> "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. . . ."

Statement.

The statement in the petition here (pp. 2-5) fails to mention the following undisputed facts on which the decision below was based. Except in negligible amounts which may be disregarded, there is no commercial market for cement rock until it is processed into cement (R. A41, Appendix, p. 9a). Here the *only* commercially marketable product is cement. The methods used by taxpayer to process cement rock into cement are the ordinary treatment processes normally applied by mine owners or operators who produce cement (R. A41, Appendix, p. 9a).

---

[1] The Government's statement of the "Question Presented" here is the same as its statement in *United States* v. *The Merry Brothers Brick & Tile Co., et al.*, No. 229, filed June 24, 1957. It is misleading and confusing because the Government ignores the statutory definition of the word "mining" and denies that certain of these ordinary treatment processes are mining processes. The petition characterizes them as "manufacturing" processes without defining what is meant by "manufacturing." It is undisputed that the taxpayer uses only the "ordinary treatment processes" normally employed by cement rock miners to produce cement. Cement is the first commercially marketable mineral product produced by miners of cement rock.

The Court of Appeals held that all of the processes which taxpayer applied to process its cement rock into cement were included in the above statutory definition of "mining" and that taxpayer's percentage depletion deduction should be based upon its gross income from cement (Appendix, p. 14a).

Argument.

The complete unanimity, without a dissenting judge, among the four Courts of Appeals which have passed on the question is a decisive reason for denial of certiorari.[2]

The petition recognizes that all authority in the Courts of Appeals supports the taxpayer's position. The question has been determined by the First, Fourth, Fifth and Tenth Circuits and there is no conflict.[2] They have all held that the statutory language is "clear and unambiguous."

The merits of the case have been completely discussed in the opinion herein of the First Circuit which reversed the decision of the District Court (the only decision in the Government's favor). The Government, in its petition, does not even present the District Court's reasoning.

---

[2] Four Courts of Appeals have written the following five unanimous opinions in support of taxpayer's position. The opinion herein, reported at 244 F. 2d 513 (1st Cir. 1957), (Appendix, 1a-14a); *United States* v. *Merry Brothers Brick & Tile Company*, 242 F. 2d 708 (5th Cir. 1957); *Townsend* v. *The Hitchcock Corporation*, 232 F. 2d 444 (4th Cir. 1956); *United States* v. *Sapulpa Brick & Tile Corporation*, 239 F. 2d 694 (10th Cir. 1956); and *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (5th Cir. 1955). In the Sixth and Ninth Circuits the same conclusion was reached by District Courts in *The Haseland Clay Works Company* v. *United States*, 56-1 U. S. T. C. Par. 9297, 1956 P.-H. Fed. Tax Service Par. 72,449 (N. D. Ohio 1956) and *Harvey* v. *United States*, 57-1 U. S. T. C. Par. 9473, 1957 P.-H. Fed. Tax Service Par. 72,532 (D. Ariz. 1957). The Tax Court has reached the same conclusion in *International Tale Company*, 15 T. C. 981 (1950); *American Gilsonite Company*, 28 T. C. ____, No. 22 (1957); *Riverton Lime & Stone Company, Inc.*, 28 T. C. ____, No. 49 (1957).

The Government does not claim but implies ambiguity in the statute by a discussion of its legislative history in the *Merry Brothers* petition[1] (the Government incorporates that petition here by reference). The clear and unambiguous language of the statute makes such a discussion unnecessary and irrelevant. In any event, the legislative history, as pointed out by Judge Magruder (Appendix, p. 12a), establishes the fact that this taxpayer's position is correct.

The Government contends (Pet., p. 5) that the decision below is erroneous because it rejects the Treasury's "long-standing interpretation" of the statute. The specific portion of the Regulation held invalid by the Court below is not of "long-standing." It was adopted on July 14, 1953, and made retroactive to 1951, the year involved.[3]

The Government also contends that a substantial loss of revenue is here involved (Pet., p. 6). Certainly it was within the power of Congress to extend the percentage depletion allowance to miners of cement rock as it did in the Revenue Act of 1951. This Court is not concerned with the wisdom of the statute covering this allowance when the language of the statute is "clear and unambiguous" (Appendix, p. 3a). Where Congress has provided a percentage depletion allowance in language which is clear and unambiguous, that allowance has the effect on the revenue which the Congress intended. This case presents no question of statutory construction that would warrant review by this Court.

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[3] T. D. 6031, 1953-2 C. B. 120, amending Regulations 111, sought to make major changes in the statutory definition of "mining" by denying that certain treatment processes are "ordinary treatment processes" even though normally applied by miners to obtain the first commercially marketable mineral product. It is this amendment to the Regulations which is in issue here and which was declared invalid in all the cases cited in footnote 2. It is therefore clear error for the Government to refer to the Regulations in issue as "long-standing".

Conclusion.

The petition does not specify any error in statutory construction by the Courts of Appeals. No question remains. Therefore, the petition herein being without merit, it should be denied.

Respectfully submitted,

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August, 1957

APPENDIX.

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT.

No. 5186.

DRAGON CEMENT COMPANY, INC.,
Plaintiff, Appellant,

v.

UNITED STATES OF AMERICA,
Defendant, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MAINE.

[144 F. Supp. 188]

Before MAGRUDER, *Chief Judge*, and WOODBURY and HARTIGAN, *Circuit Judges*.

JOSEPH B. BRENNAN with whom FREDERIC A. COLLINS, EDWARD C. THAYER and JOSEPH B. CAMPBELL were on brief, for appellant.

GERARD J. O'BRIEN, Attorney, Department of Justice, with whom CHARLES K. RICE, Assistant Attorney General, HILBERT P. ZARKY and SHELDON I. FINK, Attorneys, Department of Justice, and PETER MILLS, United States Attorney, were on brief, for appellee.

Opinion of the Court.

May 14, 1957.

MAGRUDER, *Chief Judge*. Appellant, a Maine corporation, in its capacity as successor (by merger effective November 30, 1951) to Lawrence Portland Cement Company, a Pennsylvania corporation, brought this action in the United States District Court for the District of Maine, seeking recovery of federal income and excess profits taxes for the period January 1 to November 30, 1951, in the amount of $483,522.19, with interest. The facts were not in dispute and were recited in a stipulation. Both parties having moved for summary judgment, the district court on September 24, 1956, entered a judgment the first paragraph of which (as subsequently amended) decreed that the plaintiff recover of the defendant the sum of $10,546.46, with interest, on account of a deductible tax loss under §23(f) of the Internal Revenue Code of 1939, an issue which is no longer in the case, and the second paragraph of which decreed as follows:

> "2. That plaintiff take nothing further in consequence of plaintiff's complaint as to the issue of percentage depletion and as to that issue, the action be and it is hereby dismissed on the merits."

The taxpayer has appealed from that portion of the judgment denying recovery to it under the percenta, depletion issue, so that the case now before us turns solely on a question of statutory interpretation of §114(b)(4)(B) of the 1939 Code, as amended, which defines the term "gross income from mining" for use in determining the basis for percentage depletion allowed as a deduction from income derived from certain mines and natural mineral deposits.

The allowance for depletion has been a controversial subject for years, and officials of the executive branch have sought from time to time, with conspicuous lack of success,

to persuade the Congress to eliminate some of its alleged overgenerous features. See Mertens, Law of Federal Income Taxation § 24.04 (1954). We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it.

The need for and fairness of some allowance for depletion proceeds from the fact that the production of income through the exploitation of natural resources is accompanied by an inevitable consumption of capital in the form of the gradual exhaustion of the natural resource being exploited. Thus the allowance serves to offset the injustice of classifying only as income what might be regarded as income comingled with return of capital, and serves also as an incentive to encourage capital expenditures in the direction of discovery and exploitation of natural resources.

Of the three types of depletion allowance prescribed at various times by the Congress, percentage depletion (with which we are now concerned) is to be contrasted with cost depletion and discovery depletion. Cost depletion, based upon the cost to the taxpayer of the particular deposit, seeks to return to the taxpayer free of tax that portion of his cost attributable to the amount of the deposit used up in earning the income on which he is taxed during a given taxable year. Discovery depletion seeks to reward the taxpayer for the discovery of unknown natural deposits, and has usually been based upon the fair market value of the deposit within thirty days after the date of its discovery. By the third type of depletion allowance, percentage depletion, the Congress hoped to furnish an easily computable allowance that would avoid many of the complications arising in connection with the computation of cost or discovery depletion. Percentage depletion is based upon a fixed percentage of the income realized during the taxable year from the exploitation of a piece of

property—the percentage varying, somewhat arbitrarily, depending upon the kind of deposit involved.

With the gradual enlargement of the categories of mineral properties to which the percentage depletion became applicable, the Congress has at the same time automatically eliminated discovery depletion in respect to such deposits.[1] In general, percentage depletion has remained as an alternative to cost depletion, so that even if the taxpayer fails to establish the cost of the property, he nevertheless may be entitled to the allowance of a percentage depletion. It is also true, as pointed out in Mertens, Law of Federal Income Taxation §24.31a (1954), "that through percentage depletion a taxpayer may recover more than his cost over the life of the property."

For present purposes we need go no further back than to the provisions of the Internal Revenue Code of 1939.

Section 23 of this Code contained the following (53 Stat. 12, 14):

> "Sec. 23. Deductions from Gross Income.
>
> In computing net income there shall be allowed as deductions: . . .
>
> (m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . .
>
> (n) Basis for Depreciation and Depletion.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114."

[1] The 1954 Code has now abolished discovery depletion entirely as applied to future years.

Section 114(b)(1) stated as the general rule (53 Stat. 45) that the basis for the depletion allowance should be the adjusted basis in § 113(b) for determining gain upon the sale or other disposition of such property, except as otherwise provided in the ensuing paragraphs numbered (2), (3), and (4). Paragraph (2) related to discovery value in the case of certain mines. Paragraph (3) gave a percentage depletion formula for oil and gas wells. Paragraph (4) gave percentage depletion formulas for coal, metal, and sulphur mines (but not including the type of deposit involved in the case at bar), and provided allowances based upon a prescribed percentage of the "gross income from the property during the taxable year".

The phrase "gross income from the property" was undefined as it appeared in the 1939 Code. It thus had a lurking ambiguity where the mine owner customarily performed more than merely extractive operations before realizing any income; in such cases, would the basis for the depletion allowance include gross income from what in other contexts might be described as manufacturing operations upon the extracted property? The statute did not make this point clear, and Regulations 111, as originally issued, naturally sought to narrow the scope of the allowance.

In the Revenue Act of 1943 (58 Stat. 45), the Congress attempted to resolve this ambiguity by inserting a definition of "gross income from the property" in a new § 114 (b)(4)(B), reading in part as follows:

> "(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine-owners or operators in order to obtain the commercially marketable mineral product or

products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment, and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electostatic, or magnetic), cyanidation, leading, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores."

It is apparent that the Congress intended not to limit the computation of the percentage depletion allowance to the gross income attributable to purely extractive processes, for the deposit when thus first extracted might not be in a commercially marketable form, and might require further processing. Congress accomplished this by providing for the first time a general formula, and by giving nonexclusive illustrations of processes included in the phrase "ordinary treatment processes". See § 3797(b) of the Code of 1939, 53 Stat. 470. The general formula, which of course is controlling, is that the basis for computing the percentage depletion allowance shall be the "gross income from mining", defined as including "not

merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Thus we must look to see what processing is normally undertaken by a mine owner or operator in order to obtain a commercially marketable product, and when such a salable product is obtained, then the gross income from the sale of such product is the base upon which to apply the percentage depletion allowance. That these "ordinary treatment processes" are not necessarily limited to those processes which leave the extracted deposit in its natural state is clear from the inclusion, as an illustration in §114(b)(4)(B), of the process of furnacing quicksilver ores, which involves a chemical change.

It would also be helpful, in a preliminary way, to observe that the depletion allowance is not an allowance upon any *process*, whether a mining process or a manufacturing process. Nor is it an allowance, as such, upon any product. Instead, it is an allowance to the mine owner designed as a simple means to diminish his taxable income from the exploitation of a natural resource which is necessarily exhausted in the process. In making this allowance, the Congress has elected not to limit the deduction in all cases to the taxpayer's actual cost or other basis in the land from which the ore or mineral is extracted. To supply a simpler rule, the Congress has turned more and more to the method of percentage depletion, which differs from both cost and discovery value depletion in that it is measured by an arbitrary percentage of gross income from the property, without regard to the taxpayer's cost or discovery value.

From the foregoing it is clear that by the enactment of 1943 the Congress for the first time introduced into the statute key language which had not theretofore appeared either in the statute or in the regulations thereunder, namely, a new definition of "gross income from mining" as including "not merely the extraction of the ores or

minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Notwithstanding this, the Commissioner has subsequently sought, by regulatory amendments to §29.23(m)-1(f) of Treas. Reg. 111, in cases where the mine owner customarily had to indulge in further processing other than merely extractive operations before obtaining a commercially marketable product upon which he could realize any income, to prescribe a relatively complex mathematical method for calculating the percentage depletion base. This would require an allocation of income derived from the sale of the first marketable product to the various treatment processes in proportion to their cost, with only those processes allowed as part of the base which occurred before any chemical change had taken place in the extracted mineral.

By §319 of the Revenue Act of 1951 (65 Stat. 497), the Congress amended §114(b)(4)(A) of the Internal Revenue Code so as to extend the availability of percentage depletion for the first time to "calcium carbonates," which includes deposits of cement rock, the natural resource involved in the case at bar. The prescribed percentage for calcium carbonates was ten per cent of the gross income from mining the deposit.

With the foregoing stated by way of background, it will perhaps be easier to understand the significance of the facts in the present case.

Throughout the tax period in question, Lawrence Portland Cement Company, the taxpayer-appellant's predecessor, owned and operated two quarries, one in Maine and the other in Pennsylvania, from which it extracted cement rock, a calcium carbonate suitable for conversion into cement. The operations began with drilling and primary blasting from the face of the quarry by the open pit method to obtain the cement rock, which was then broken into manageable size by secondary blasting and loaded by shov-

els into dump trucks which carried it to an inclined railway where it was deposited into dump rail cars for transportation to the near-by plant.

Treatment or "beneficiation" then occurred at the plant in the following processes: The dump rail cars deposited the cement rock into a large primary crusher, which reduced the size of the extracted rock to pieces with a maximum dimension of about eight inches. After this primary crushing, the cement rock fell onto a conveyor belt which carried it to a secondary crusher which further reduced the size of the rock. From the secondary crusher a conveyor belt carried the cement rock to a shed, from which it was picked up by an overhead crane which deposited the desired quantities into a hopper, over which a coarse bar grate was fitted to screen the crushed cement rock. From the hopper, the screened cement rock was gravity-fed to a ball mill where it was ground with water to a proper fineness known as "slurry," which was then conveyed to a wet "slurry" tank where it was kept in suspension by a revolving paddle mechanism. The "slurry" was then run off to filters where much of the water was removed, and the resulting filter cake was thereafter conveyed by belt to rotary kilns.

There is no dispute that the gross income allocable to the operations thus far described may be included in determining the gross income from mining of the mineral, cement rock, for the purpose of calculating the base to which the allowable percentage depletion is to be applied. But it was found as a fact by the trial court, and we understand that this is not controverted by the government, that except in negligible amounts, which may be disregarded, "there is no commercial market for cement rock. The first commercially marketable product is cement. The methods used by taxpayer to transform cement rock into cement are admitted to be the 'ordinary treatment processes normally applied by mine owners or operators' who produce cement."

Accordingly, the taxpayer's predecessor had to engage in further processes before obtaining a marketable prod-

net, cement, upon which gross income could be realized. The so-called filter cake was run into the upper end of rotary kilns, which were in the form of long rotating cylinders set at a slight inclination, the filter cake gradually traveling toward the lower end of the kiln. Hot gases from a flame at the lower end evaporated the water from the filter cake and burned the remaining material to a dense clinker. The clinker was then conveyed to a grinding mill where it was ground to the fineness of cement; the cement was finally placed in silos from which it was loaded and shipped in bags or in bulk. It is conceded that these last processes effected a chemical change in the cement rock, transforming it from its crude mineral state into cement, which is synthetic and not a mineral.

The dispute here involves the propriety of including income allocable to the kiln and post-kiln processes in gross income from mining, as defined; if such processes are excluded, the depletion allowance for the taxable period would be $204,859.19, whereas, if such processes are included, the allowable depletion would be $795,852.60.

It is contended by the government that mining terminated, and that the depletion base was arrived at, when the mine operator had prepared the cement rock for conversion, and that the subsequent operations, during which it underwent a chemical change and ceased to be a mineral, constituted a manufacturing process, not allowable in computing the depletion base. As indicated above, this contention is fully supported by Treas. Reg. 111, § 29.23(m)-1(f), but the taxpayer maintains that the regulation is invalid in this respect because the definition of "gross income from mining", inserted in § 114(b)(4)(B) in 1943, does not permit such an interpretation, but on the contrary compels the opposite result. Although the district court upheld the government's view, we find ourselves in agreement with the taxpayer.

Opinion of the Court.

Preliminary to upholding the government's asserted interpretation, the district court concluded that the statutory language, "commercially marketable mineral product or products", was intrinsically ambiguous. One possibility, the district court said, was to construe the phrase as permitting the depletion allowance to extend to a product of a mineral, although the end product may be a synthetic non-mineral (*viz.*, a commercially marketable mineral *product*). The second possibility, said the district court, was to construe the statutory phrase as restricting the depletion allowance to products still in a mineral state (*viz.*, a commercially marketable *mineral* product).

We are unable to perceive that the statutory language contains any such inherent ambiguity. In this connection it should be observed that three other courts of appeals which have had occasion to weigh the government's arguments advanced in the case at bar, and to construe the critical statutory phrase, have held it to be "clear and unambiguous" in favor of the taxpayer's interpretation. See *United States v. Cherokee Brick & Tile Co.*, 218 F.2d 424, 425 (C. A. 5th, 1955); *Townsend v. The Hitchcock Corp.*, 232 F.2d 444, 446 (C.A. 4th, 1956); *United States v. Sapulpa Brick & Tile Corp.*, 239 F.2d 694, 697 (C.A. 10th, 1956). We are not persuaded that we ought to create a conflict with our brethren in other courts of appeals with respect to this matter.

In the first place it should be noted that cement has been consistently classified as a "mineral product" both in scholarly compilations of a general sort, such as the Encyclopedia Britannica,[2] and in publications of specialized government agencies which compile information and statistics on the mining industry. Such classification has been made by the Bureau of Mines and the Bureau of the Census, both of which had listed cement as a "mineral product" at the time the statutory definition of "gross income from

[2] 22 Encyc. Britannica 753, Table XIII (1954).

property" was enacted in the Revenue Act of 1943,[3] and this classification has been continued in the latest publications of these agencies.[4]

Furthermore, it is well known that the word "mineral" is frequently used before other words to describe products which are manufactured from minerals but which are not themselves composed of minerals in the natural state. In such usage it qualifies the noun which follows and indicates mineral origin; for example, "mineral wool" is a generic term which can be applied to various insulation products manufactured from minerals.[5] The dictionary furnishes many similar examples.[6]

The legislative history of § 114(b)(4)(B) provides additional support for the interpretation of the statutory definition which we, along with other courts of appeals, have adopted. In order to support its conclusion that cement is not a "mineral product" within the meaning of the statutory definition, the district court seized upon the word "mineral" as the crucial word in the phrase "the commercially marketable mineral product or products." However, that "mineral" is not the crucial word is made clear by the Senate Finance Committee Report which explained

[3] Minerals Yearbook for 1942, pp. 37, 45, 48 (1943); Statistical Abstract of the United States, 1942, p. 845. In addition, the Statistical Abstract statistics as to production of cement (pp. 879, 888) appear in a section entitled "Mining and Mineral Products."

[4] Minerals Yearbook for 1953, vol. I, p. 20 (1956); Statistical Abstract of the United States, 1956, pp. 732, 743.

[5] 9 Kirk & Othmer, Encyc. of Chemical Technology 122 (1952).

[6] *E.g.*, *mineral oil*: "Any oil of mineral origin, as petroleum, shale oil, or any oil *obtained from them by refining*"; *mineral water*, "Any water naturally or *artificially* impregnated with mineral salts or gases"; *mineral jelly*, a "semisolid substance *from petroleum* . . . used as a stabilizer in explosives"; *mineral spirits*, a "volatile petroleum product, intermediate between gasoline and kerosene, used extensively as a thinner for paints and varnishes"; *mineral rubber*, which includes "an asphalt *artificially* obtained or treated." (Italics added.) Webster's New International Dictionary, Unabridged (2d ed. 1953).

the meaning of the section added by that committee to the Revenue Act of 1943:

> "The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a *marketable product* should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. (Italics added.) Sen. Rep. No. 627, 78th Cong., 1st Sess., 23, 1944 Cum. Bull. 973.

In other words, although the draft of the bill to which the above report referred contained the word "mineral" and the phrase was in the same form as in the final Act, the committee did not even use the word "mineral" in explaining that the purpose of the statutory provision was to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, as defined.

Nor can we accept the government's contention that the Congress in 1943 was concerned solely with making clear that concentration processes, equivalent to those which had previously been listed in the applicable regulations, were intended to be included as a part of the mining operation, for in defining "gross income from mining" the Congress introduced new language which had never previously appeared in the history of the depletion allowance. Furthermore, the Senate Finance Committee Report which explained the provision gave no hint that Congress intended only to include such "equivalent concentration processes". Quite the contrary, as the previous quotation shows, the committee report stated that the purpose of the new provision was "to make certain that the ordinary treatment processes which a mine operator would normally apply to

obtain a marketable product should be considered as a part of the mining operation".[1]

For the reasons above indicated, we conclude that the taxpayer is entitled to a percentage depletion deduction based upon its gross income from cement, as the first commercially marketable mineral product obtained from the deposit, calcium carbonate, after the ordinary treatment processes normally applied by such mine owners. To the extent that §29.23(m)-1(f) of Treas. Reg. 111 is inconsistent with this conclusion, it must be declared to be invalid. See *Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, 134 (1936).

A judgment will be entered vacating that portion of the judgment of the District Court now under review, and remanding the case to the District Court for further proceedings not inconsistent with this opinion.

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[1] It should also be observed that the government's position is subject to the anomaly that under its interpretation there never is a "commercially marketable mineral product" obtained from cement rock. Thus, to be perfectly consistent, "mining" under §114(b)(4)(B) would not include any "ordinary treatment processes" applied to cement rock, since mining includes only "ordinary treatment processes" applied to obtain the "commercially marketable product or products."